Supreme Court, U.S.
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No. 06-

IN THE

Supreme Court of the United States

LANCO, INC.,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of New Jersey

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Supreme Court of New Jersey erred when it concluded – expressly acknowledging a split among the States on the question – that the Commerce Clause of Art. I, § 8, permits a State to impose an income tax on an out-of-state corporation that has no physical presence in the taxing State.

RULE 29.6 STATEMENT

Petitioner Lanco, Inc. was a wholly owned subsidiary of Limited Brands, Inc., a publicly-held company, during the fiscal year ending January 31, 1998, the tax period involved in this dispute. Petitioner was sold on August 16, 2001, to Venice Acquisition Corporation, a subsidiary of Charming Shoppes, Inc., a publicly-held company, after which it became a subsidiary of Charming Shoppes, Inc.; Limited Brands, Inc., however, agreed to indemnify the purchaser for liabilities related to pre-closing tax periods. Petitioner was merged into another subsidiary of Charming Shoppes, Inc., on April 29, 2005.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

RULE 29.6 STATEMENT ii

TABLE OF AUTHORITIES v

PETITION FOR A WRIT OF CERTIORARI 1

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED 1

INTRODUCTION 1

STATEMENT OF THE CASE 5

REASONS FOR GRANTING THE PETITION 9

I. THE STATES ARE IN CONFLICT OVER THE APPLICABILITY OF THE *BELLAS HESS/QUILL* PHYSICAL PRESENCE REQUIREMENT TO INCOME AND FRANCHISE TAXES 9

A. Several State Supreme Court And Appellate Court Decisions Require Physical Presence For Income And Franchise Taxes 9

B. Other State Supreme Court And Appellate Court Decisions Reject a Physical Presence Requirement For Income And Franchise Taxes 12

C. Certiorari Should be Granted Now to Resolve this Important Conflict 15

II. THE DECISION BELOW IS WRONG AND CONFLICTS BOTH WITH THIS COURT'S COMMERCE CLAUSE DECISIONS AND WITH THE PRINCIPLES OF FEDERALISM THEY REFLECT 18

A. This Court's Commerce Clause Precedents Do Not Distinguish Among Types Of State Taxes..... 18

B. The Bright-Line, Physical-Presence Requirement Provides A Judicially Manageable Default Rule 22

C. The Physical-Presence Test Reflects And Reinforces The Nature of The Federal System..... 25

D. The Idea That the Use in a Particular State by a Licensee of a Business's Intangible Property Alone Constitutes a "Presence" of that Business in that State Does Not Provide a Principled Distinction from Instances Where Physical Goods Alone are Shipped into a State 26

III. THIS COURT SHOULD AGAIN INTERVENE TO PROTECT THE FREE FLOW OF INTERSTATE COMMERCE..... 28

CONCLUSION..... 30

TABLE OF AUTHORITIES

Page

Cases

A&F Trademark, Inc. v. Tolson,
605 S.E.2d 187 (N.C. 2004).....7, 14, 23

Allied-Signal v. Dir., Division of Taxation,
504 U.S. 768 (1992).....25, 28

Amerada Hess Corp. v. Dir., Div. of Taxation,
490 U.S. 66 (1989).....19

Am. Dairy Queen Corp. v. Taxation & Revenue Dep't,
605 P. 2d 251 (N.M. Ct. App. 1979).....28

Barclays Bank PLC v. Franchise Tax Bd.,
512 U.S. 298 (1994).....19

BMW of N. Am., Inc. v. Gore,
517 U.S. 559 (1996).....25

Buehner Block Co. v. Wyo. Dep't of Revenue,
139 P.3d 1150 (Wyo. 2006).....13

Colonial Pipeline Co. v. Traigle,
421 U.S. 100 (1975)..... 18-19

Commonwealth Edison Co. v. Montana,
453 U.S. 609 (1981).....18

Complete Auto Transit v. Brady,
430 U.S. 274 (1977)..... *passim*

Container Corp. of Am. v. Franchise Tax Bd.,
463 U.S. 159 (1983).....17

Couchot v. State Lottery Comm'n,
659 N.E.2d 1225 (Ohio).....12, 14

Curry v. McCanless,
307 U.S. 357 (1939).....27, 28

Farmers Loan & Trust Co. v. Minnesota,
280 U.S. 204 (1930).....27

Gen. Motors Corp. v. City of Seattle,
25 P.3d 1022 (Wash. App. 2001) 14, 22

Geoffrey, Inc. v. Oklahoma Tax Commission,
132 P.3d 632 (Okla. Civ. App. 2005) 14

Geoffrey, Inc. v. SC Tax Comm'n,
437 S.E.2d 13 (S.C. 1993) ..... *passim*

Guardian Indus. Corp. v. Dep't of Treasury,
499 N.W.2d 349 (Mich. 1993) 11

J.C. Penney Nat'l Bank v. Johnson, Comm'r of Revenue,
No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000) 10

J.C. Penney Nat'l Bank v. Johnson,
19 S.W.3d 831 (Tenn. Ct. App. 1999) 8, 9-10

J.W. Hobbs Corp. v. Dep't of Treasury,
706 N.W.2d 460 (Mich. App. 2005) 11

Kmart Props., Inc. v. Taxation & Revenue Dep't of N.M.,
131 P.3d 27 (N.M. Ct. App. 2001) 14

Meadows v. State,
849 S.W.2d 748 (Tenn. 1992) 10

Messina v. State,
904 S.W.2d 178 (Tex. 1995) 11

National Bellas Hess, Inc. v. Department of Revenue,
386 U.S. 754 (1967) ..... *passim*

National Geographic Soc'y v. Cal. Bd. of Equalization,
430 U.S. 551 (1977) 19, 20

Pairamore v. Pairamore,
547 S.W.2d 545 (Tenn. 1977) 10

Pope v. Atlantic Coast Line R.R. Co.,
345 U.S. 379 (1953) 8

Quill Corp. v. North Dakota,
504 U.S. 298 (1992) ..... *passim*

Rylander v. Bandag Licensing Corp.,
18 S.W.3d 296 (Tex. App. 2000) 11

Scripto, Inc. v. Carson,
362 U.S. 207 (1960) 2

State Farm Mut. Auto. Ins. Co. v. Campbell,
538 U.S. 408 (2003) 25

State v. Cawood,
154 S.W.3d 159 (Tenn. 2004) 10

Straman v. Lewis,
559 N.W.2d 405 (Mich. App. 1996) 11

Tax Comm'r v. MBNA America Bank,
640 S.E.2d 226 (W. Va. 2006) ..... *passim*

Tebo v. Havlik,
343 N.W.2d 181 (Mich. 2004) 11

Tyler Pipe Indus. v. Wash. State Dep't of Revenue,
483 U.S. 232 (1987) 2

United States v. Lopez, 514 U.S. 549 (1995) 23, 25, 26

Constitutional Provision

U.S. Const. Art. I, §8 1

Legislative and Regulatory Materials

15 U.S.C. § 381 20
28 U.S.C. § 1257 ..... 1, 8
28 U. S. C. § 1341 15
Ark. Reg. 1996-3 14
Directive 96-2 (Mass. Dep't of Revenue July 3, 1996) 15
Fla. Admin. Code Ann. r. 12C-1.001 (2007) 14
H.R. 3184, 108th Cong. (2003) 3
Iowa Admin. Code r. 701.521(1)d (2007) 14
Iowa Admin. Code r. 701.521(422) (2007) 14
Minn. Stat. § 290.015 (2005) 15
N.J. Stat. Ann. § 54:10A-1 (2007) 6
N.J. Stat. Ann. § 54:10A-2 (2007) 21

N.J. Stat. Ann. § 54:10A-5 (2007) 20
Okla. Admin. Code § 710:50-17-3(a)(9) (2005) 15
S. 1736, 108th Cong. (2003) 3
S. 2152, 109th Cong. (2005) 3
S. 2153, 109th Cong. (2005) 3
Tenn. Code Ann. §116-4-113 (2007) 10
Wis. Admin. Code § 2.82(4)9 15

Other Authorities

2006 Survey of State Tax Departments, (BNA). Vol. 13, No. 4 (April 28, 2006) 4, 12

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J. Hellerstein & W. Hellerstein, State and Local Taxation (8th ed. 2005) 2, 4

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Model Income Tax Convention of November 15, 2006 17

Multistate Tax Commission, Model Statute, Factor Presence Nexus Standard for Activity Taxes (Oct. 17, 2002) 4

SEC, Codification of Financial Reporting Policies § 101 16

State of New Jersey Nexus Survey (July 17, 2006) 17

PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully seeks this Court's review of the judgment of the Supreme Court of New Jersey.

OPINIONS BELOW

The opinion of the Supreme Court of New Jersey (Petition Appendix ("App.") 1a-3a) is reported at 908 A.2d 176. The decision of the Appellate Division of the Superior Court of New Jersey (App. 4a-20a) is reported at 879 A.2d 1234. The decision of the New Jersey Tax Court (App. 21a-42a) is reported at 21 N.J. Tax 200.

JURISDICTION

The judgment of the Supreme Court of New Jersey was entered on October 12, 2006 (App. 1a). On December 22, 2006, Justice Souter extended the time for filing this Petition to and including February 9, 2007. On January 26, 2007, Justice Souter again extended the time for filing this Petition to and including March 9, 2007. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The relevant New Jersey statutory and regulatory provisions are set forth at App. 43a - 50a.

INTRODUCTION

This Petition presents the question whether the Commerce Clause permits States to impose income and franchise taxes on an out-of-state entity with no in-state physical presence. This is a question of enormous practical importance on which the States are squarely in conflict.

Forty years ago in its seminal decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 754 (1967), this Court confirmed the longstanding rule that a State imposes an unconstitutional burden on interstate commerce when it attempts to force tax collection and remittance responsibilities on an out-of-state entity that lacks any "physical presence in the taxing State." *Quill Corp. v. North Dakota*, 504 U.S. 298, 314 (1992). Subsequently, in 1977, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court adopted a general test for dormant Commerce Clause challenges to the exercise of state taxing power, deciding in relevant part that, in the absence of congressional action, the Commerce Clause permits taxation of out-of-state businesses only where, *inter alia*, the tax "is applied to an activity with a substantial nexus with the taxing State." *Id.* at 279. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Court applied this test in the context of sales and use taxes and reaffirmed *Bellas Hess*, holding that an out-of-state corporation has a "substantial nexus" with the State for purposes of such taxes only where the corporation has a "physical presence" in the taxing State. *Id.* at 314.[1]

Consistent with the decisions of this Court, "courts traditionally have regarded a corporation's physical presence in a state as necessary to establish jurisdiction to subject that corporation to income taxation in the state." J. Hellerstein & W. Hellerstein, State and Local Taxation 386 (8th ed. 2005).

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[1] The phrase "physical presence" as it is used in both *Quill* and this Petition is a term of art including not only maintenance of an office, ownership of real property, or maintenance of employees in-state, but also the conduct of certain "activities performed in . . . state on behalf of the taxpayer," for example, the solicitation of orders for sales by independent contractors. *See Tyler Pipe Indus. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250 (1987) (internal quotation marks and citation omitted); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Quill*, 504 U.S. at 306 (cataloguing the cases and explaining that "all involved some sort of physical presence within the state").

Indeed, while both *Bellas Hess* and *Quill* involved state sales and use taxes, neither before *Complete Auto* nor after has this Court ever upheld the imposition of *any* state tax on an out-of-state entity in the absence of some physical presence in the taxing State. This makes sense: This Court has made clear that the relevant question in distinguishing tax statutes for purposes of Commerce Clause analysis is whether they have the same effect. "[D]ifferently denominated tax[es]" that operate in the same way will be treated identically. *Quill*, 504 U.S. at 310; *see Complete Auto*, 430 U.S. at 284 (noting that a gross receipts tax can be reworded as a franchise tax on intangible property in the form of "going concern" value, but that there would be "no real economic difference between the statutes"). In the forty years since *Bellas Hess*, Congress – which "has the final say over regulation of interstate commerce[] and . . . can change the rule of *Bellas Hess* simply by saying so," *Quill*, 504 U.S. at 320 (Scalia. J. concurring in part and concurring in the judgment) – has never acted to eliminate or modify the physical-presence rule. Indeed, Congress has repeatedly rejected attempts to permit the States broader authority to tax out-of-state entities that engage in interstate commerce. *See, e.g.*, S. 2152, 109th Cong. (2005), S. 2153, 109th Cong. (2005), S. 1736, 108th Cong. (2003), H.R. 3184, 108th Cong. (2003).

Nonetheless, at about the time *Quill* was decided, the taxing authorities in a number of States seeking new ways to obtain revenue from out-of-state taxpayers began imposing corporate income and franchise taxes on out-of-state businesses whose sole contact with the State was sales to in-state customers. States have tried to tax any business operating anywhere in the nation, pursuing music publishers because their songs are available on the radio to in-state listeners; cable TV producers because their programs are available to in-state viewers; and licensors of computer software because

their intangible products are being "used" in a State.[2] State courts have increasingly sanctioned the unprecedented imposition of such income and franchise taxes. To avoid the force of *Bellas Hess* and *Quill*, these courts have held that physical presence is required *only* for the imposition of sales and use taxes, and not for income, franchise, and other types of business operation taxes. App. 3a.

The first case ever to hold that "the taxpayer need not have a tangible, physical presence in a state for income to be taxable there" was *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E. 2d 13, 18 (S.C. 1993). The *Geoffrey* case generated "an enormous outpouring of commentary." *See* Hellerstein and Hellerstein, *supra*, at 394. It also led to a direct conflict in authority among the States about the permissible scope under the Commerce Clause of state authority to tax out-of-state corporations engaged in interstate commerce. In several States, courts have retained the traditional physical presence rule under the Commerce Clause. *See infra* at 9-12. In other States, the courts – including now the New Jersey Supreme Court below – have followed *Geof-*

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[2] *See, e.g.*, 2006 Survey of State Tax Departments, (BNA). Vol. 13, No. 4 at S-20-21 (April 28, 2006), available at http://www.bna.com/states/statesurvey/2006survey.pdf (last visited March 5, 2007) (24 States and the District of Columbia indicated that they would assert nexus over a company for purposes of income taxes if the company licenses standard software for use in their jurisdiction); Multistate Tax Commission, Model Statute, Factor Presence Nexus Standard for Activity Taxes (Oct. 17, 2002), available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf (last visited March 5, 2007) (nexus established if sales threshold exceeded, includes sales of intangible and digital products); *Business Activity Tax Simplification Act of 2003: Hearing Before the Subcomm. on Commercial & Administrative Law of The House Comm. on the Judiciary*, 108th Cong., 2d Sess., at 65 (2004) (Rep. Meeks) ("some states have alleged that income-based taxes are due from media corporations simply because they broadcast programs into the state"); *id.* at 88-89 (statement of Bo Horne and Kathy Horne, owners of a home-based software development company).

frey's lead and have allowed the imposition of income and franchise taxes even absent a physical presence within the State. *See infra* at 12-15.

There is now a clear and irreconcilable division of authority on this important question. The result is an untenable patchwork of standards, in which some state taxing authorities are permitted to tax out-of-state entities that lack physical presence and others are not, and in which no corporation can predict whether and where its commercial activities will subject it to state taxation. The scope of the States' authority to tax beyond their borders is an issue of fundamental importance to virtually every business involved in interstate or international commerce. It is of particular significance to that critically important sector of the economy that engages in commerce over the internet. These new tax assessments violate settled expectations upon which large segments of the American economy have relied in development and long-term planning, and they directly burden and disrupt the free flow of interstate commerce that the Commerce Clause exists to protect. That disruption will necessarily intensify until this Court clarifies and confirms the application of the longstanding physical presence rule to all state taxes. Certiorari should be granted.

STATEMENT OF THE CASE[3]

1. Petitioner Lanco, Inc. ("Petitioner" or "Lanco"), was at all times relevant to this litigation a Delaware corporation that owned trademarks, tradenames and service marks ("intellectual property") which it licensed to Lane Bryant, Inc. ("Lane Bryant"), a corporation engaged in the retail sale of women's clothing and accessories, for Lane Bryant's use nationwide. Lane Bryant had stores in New Jersey, and used

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[3] All the facts recited in this Petition are taken from the stipulated factual record; no facts in this case were ever in dispute.

Lanco's intellectual property that it had licensed in connection with its operations of those stores. App. 6a, 53a.

Lanco had no New Jersey office and conducted all of its business, including all of its licensing activities, outside the State. *Id.* 53a-54a. Lanco had no employees or agents in the State and maintained no bank or other financial accounts in New Jersey. *Id.* 53a Lanco held no interests in real or personal property located in New Jersey. *Id.* Lanco and Lane Bryant had a common ultimate parent company. As the decisions below specifically found, however, their affiliation was not relevant to the determination by Respondent that tax was owed and was therefore immaterial to the constitutional issue presented by that determination. *See Id.* 6a-7a; *see also infra* at 23 n.9. The parties stipulated that Lanco licensed its property to Lane Bryant at arms-length rates. *Id.* 53a.

Respondent, the Director of the New Jersey Division of Taxation, issued a notice to Lanco that asserted that Lanco was subject to New Jersey's Corporation Business Tax ("CBT"), N. J. Stat. Ann. § 54:10A-1, *et seq.* – which is denominated a "franchise tax" and which imposes a tax upon a portion of a corporation's "entire net income" – because of its receipt of royalties from Lane Bryant. Petitioner filed this action in the New Jersey Tax Court challenging the imposition of this New Jersey tax upon it.

The New Jersey Tax Court concluded that, because Petitioner had "no physical presence" in the State, it did not have a "substantial nexus" to New Jersey, and that imposition of the CBT in this case violated Commerce Clause limitations on the State's taxing authority. App. 21a-42a. The Tax Court rejected Respondent's argument that the Commerce Clause does not require physical presence when a state income tax is at issue, rather than a sales and use tax like the one at issue in *Quill*. The Tax Court explicitly noted the division of authority on this question, App. 32a-33a. Recognizing that "the precedents continue to require physical presence for nexus," the court concluded that if "physical pres-

ence is a constitutional necessity for one, it is illogical that it should not be for both." App. 29a.

2. The Appellate Division of the Superior Court of New Jersey reversed. App. 4a-20a. The sole basis for imposing the tax on Lanco, the court explained, was "that Lanco derived receipts from sources in the State." *Id.* 5a. "Thus," the Appellate Division continued, "the critical issue is whether the taxpayer must have a physical presence in the state in order to constitute the required 'substantial nexus' necessary to satisfy the Commerce Clause under *Quill*." *Id.* 6a.

The Court held that Petitioner need not have a physical presence in the State in order to be subject to the State's income tax: "We agree with the Director that *Quill* does not apply to taxes other than sales and use taxes, and that the Corporation Business Income Tax may be constitutionally applied to impose a tax on plaintiff's income from licensing fees attributable to New Jersey." App. 11a (citation omitted); *see also id.* 20a (restating this holding).

Lanco sought review of the decision in the New Jersey Supreme Court, and the Division of Taxation did not oppose, agreeing that the "Appellate Division decision addresses a substantial question under the United States Constitution on which there is a divergence of precedent and that it is in the [Director's] interest to have the question resolved." *See* Certification of New Jersey Assistant Attorney General Patrick DeAlmeida in No. 58,542, *Lanco, Inc. v. Director, Division of Taxation* at 2, ¶[8 (N.J. Filed Nov. 15, 2005).

3. The New Jersey Supreme Court affirmed "substantially for the reasons expressed in" the opinion of the Appellate Division. App. 2a. It wrote only to add explicitly that

> Since the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court's holding was limited to sales and use taxes. *See, e.g., A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 193-96 (N.C. Ct. App. 2004)) (holding

> North Carolina can impose corporate franchise and income taxes on companies not physically present in North Carolina), *certif. denied*, 359 N.C. 320, *cert. denied*, 126 S. Ct. 353 (2005); *J.C. Penney Nat'l Bank v. Johnson,* 19 S.W.3d 831, 838-39 (Tenn. Ct. App. 1999) (holding Tennessee cannot impose franchise and excise tax on company not physically present in Tennessee), *cert. denied*, 531 U.S. 927 (2000).
>
> We believe that the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes. . . . . We therefore affirm the Appellate Division's determination that the Director constitutionally may apply the Corporation Business Tax notwithstanding a taxpayer's lack of a physical presence in New Jersey . . . .

App. 2a-3a.[4]

4. Because there is a division of authority about the important constitutional question involved in this case, this Petition followed.

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[4] The New Jersey Supreme Court ordered a remand upon which the New Jersey Tax Court entered judgment for Respondent. *See Lanco v. Tax Division*, No. 005329-1997, Consent Order and Judgment (N.J. Tax Ct. January 8, 2007). This limited remand does not affect the decision's finality for purposes of this Court's jurisdiction under 28 U.S.C. § 1257. *See Pope v. Atlantic Coast Line R.R. Co.*, 345 U.S. 379, 382 (1953).

REASONS FOR GRANTING THE PETITION

I. THE STATES ARE IN CONFLICT OVER THE APPLICABILITY OF THE *BELLAS HESS/QUILL* PHYSICAL PRESENCE REQUIREMENT TO INCOME AND FRANCHISE TAXES.

The States are divided on the question whether the Commerce Clause prohibits the imposition of income and franchise taxes upon out-of-state corporations with no in-state physical presence. With its decision below, the New Jersey Supreme Court has taken one side in this conflict about the meaning of the Constitution. This Court should act to resolve this division of authority.

A. Several State Supreme Court And Appellate Court Decisions Require Physical Presence For Income And Franchise Taxes.

The decision below squarely conflicts with the decision of the highest court of Tennessee and with the unchallenged decisions of appellate courts in other States. In *J.C. Penney National Bank v. Johnson*, the Tennessee Supreme Court upheld on its merits a decision that state taxing authorities could not impose upon out-of-state corporations with no in-state physical presence excise and franchise taxes on corporate earnings or profits. The Tennessee Court of Appeals held that no valid distinction can be drawn for Commerce Clause purposes between excise and franchise taxes and the sales and use taxes at issue in *Bellas Hess* and *Quill*:

> The only real issue is whether there is any reason to distinguish the present case from *Bellas Hess* and *Quill*. The Commissioner argues that those cases are distinguishable because they involved use taxes, whereas the present case involves franchise and excise taxes. We must reject the Commissioner's argument. While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case. In fact, the Commissioner is

> unable to provide any authority as to why the analysis should be different for franchise and excise taxes.

J.C. Penney, 19 S.W.3d at 839.

The Tennessee Supreme Court then issued an Order denying review and allowing the Court of Appeals decision to be published. *See J.C. Penney Nat'l Bank v. Johnson, Comm'r of Revenue*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000) (per curiam). Denial of review by the Tennessee Supreme Court – unlike denial of certiorari by this Court – establishes agreement with the result below.[5] Further, by allowing the Court of Appeals opinion to be published, the Tennessee Supreme Court gave it statewide precedential effect. As the Tennessee Supreme Court has explained, "the published opinions of the intermediate appellate courts are opinions which have precedential value and may be relied upon by the bench and bar of this state as representing the present state of the law with the same confidence and reliability as the published opinions of this Court, so long as either are not overruled or modified by subsequent decisions." *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1993); see also Tenn. Code Ann. §16-4-113 (2007) (Tennessee Court of Appeals is a court of statewide jurisdiction). It is thus now settled law in Tennessee that taxes upon income are subject to the *Bellas Hess/Quill* physical-presence rule.

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[5] *See, e.g., State v. Cawood*, 134 S.W.3d 159, 164 n.6 (Tenn. 2004) ("when the Supreme Court denies a writ of certiorari, the Court takes jurisdiction and makes a final disposition of the case by approving the final decree of the intermediate court"); *Pairamore v. Pairamore*, 547 S.W.2d 545, 548-549 (Tenn. 1977) ("When we deny the writ, we . . . have made a final disposition of the case by approving the final decree of the Court of Appeals. . . . [D]enial of the writ necessarily puts the stamp of approval on the results reached in the final decree of the intermediate court. . .").

Appellate courts in Michigan and Texas have also rejected attempts by their state revenue departments to impose taxes on the basis of receipts derived from in-state sources, holding that under this Court's decision in *Quill*, the Commerce Clause precludes a State from imposing franchise or income taxes on an entity that does not have a physical presence in the State.

The Michigan Court of Appeals rejected the State's effort to deviate from *Quill* in *Guardian Industries Corp. v. Department of Treasury*, 499 N.W.2d 349, 377 (Mich. Ct. App. 1993), *appeal denied*, 512 N.W.2d 846 (Mich. 1994). Michigan appellate decisions are binding precedent statewide. *See Tebo v. Havlik*, 343 N.W.2d 181, 185 (Mich. 2004); *Straman v. Lewis*, 559 N.W.2d 405, 406 (Mich. App. 1996). And, while the Michigan Supreme Court has not ruled on the issue, following the denial of review of the *Guardian* case by that court, the Michigan Department of Revenue announced that it would adhere to the physical presence standard. *See J.W. Hobbs Corp. v. Dep't of Treasury*, 706 N.W.2d 460, 463 (Mich. App. 2005). Because the State has accepted this decision, it no longer seeks to impose taxes on corporations that are not physically present, and there is no prospect of further state court judicial review of the question. In Michigan, then, the physical presence test is settled law.

In *Rylander v. Bandag Licensing Corp.*, the Texas Court of Appeals held that a franchise tax could not be imposed on a corporation that lacked physical presence in Texas and whose only connection with Texas was by way of interstate commerce. *See Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 298-300 (Tex. App. 2000), *review denied*, No. 00-0646 (Tex. January 11, 2001). In Texas, that appellate decision is binding precedent. *See Messina v. State*, 904 S.W.2d 178, 181 (Tex. 1995). The Texas decision in *Bandag* has been on the books and has governed taxation by the State for the past six years. The Texas Supreme Court de-

nied review in that case, has not taken it up in the years since, and, because of its discretionary docket, cannot be compelled to address the question. Corporations deciding whether to file tax returns in Texas thus rely on *Bandag*'s holding that the state's taxing power remains governed by the *Bellas Hess/Quill* physical presence rule with regard to all types of taxes.

In addition to these judicial rulings, a number of other States appear to have responded administratively to the movement among the States to tax out-of-state corporations that lack a physical presence in-state by making clear that the will not seek to exercise any such taxing authority. *See* 2006 Survey of State Tax Departments, (BNA). Vol. 13, No. 4 at S-20-21 (April 28, 2006), available at http://www.bna.com/states/statesurvey/2006survey.pdf (last visited March 5, 2007) (indicating that the tax authorities of Connecticut, Mississippi, Missouri, New York and Virginia also would not find a sufficient nexus to support imposition of an income-based tax where an out-of state company licensed trademarks for use in-state). These interpretations of the nexus requirement are effectively the settled law in these States, too, for as long as these interpretations remain in place there will be no judicial review of these positions because no taxes subject to challenge are imposed.

B. Other State Supreme Court And Appellate Court Decisions Reject a Physical Presence Requirement For Income And Franchise Taxes.

On the other side of the split, in addition to the Supreme Court of New Jersey below, the highest courts of South Carolina, West Virginia and Ohio have held that, despite *Quill* and *Bellas Hess*, States may impose income and franchise taxes upon out-of-state entities with no physical presence in the State. *See Tax Comm'r v. MBNA Am. Bank*, 640 S.E. 2d 226, 234 (W. Va. 2006); *Geoffrey*, 437 S.E.2d at 18; *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1230 (Ohio 1996), *cert. denied*, 519 U.S. 810 (1996); *see also*

Buehner Block Co. v. Wyo. Dep't of Revenue, 139 P.3d 1150, 1158 n.6 (Wyo. 2006) (stating that "*Bellas Hess* and *Quill* . . . created [a] specialized jurisprudence" applicable to "sales or use tax case[s]").

The West Virginia Supreme Court's recent decision in *MBNA* squarely addresses the issue presented here and – like the decision below – acknowledges the direct conflict in authority:

> [T]he United States Supreme Court's determination in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), that an entity's physical presence in a state is required to meet the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes. . . . Rather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes. . . . We reject the reasoning in *J.C. Penney*, and decline to apply it to the instant case.

MBNA, 640 S.E.2d at 234. In a microcosm of the broader conflict, the *MBNA* decision divided the West Virginia Supreme Court. A spirited dissent explained why the majority's refusal to apply the physical-presence test to income and franchise taxes contradicts this Court's Commerce Clause taxing power jurisprudence:

> The reality is that the United States Supreme Court has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved. Rather, the . . . Court has focused instead on the effect of the tax which the taxing state seeks to levy on interstate commerce . . . . Indeed, there is no immediately clear doctrinal foundation which can be observed for distinguishing sales and use tax collection on sales between states from

> income taxes sought to be collected from out-of-state companies for income realized from out-of-state intangible accounts simply because the out-of-state corporation availed itself of the United States mails and other forms of interstate communication.

640 S.E. 2d at 239 (Benjamin, J., dissenting).

Like the West Virginia Supreme Court, the Ohio Supreme Court has held that "the physical-presence requirement of *Quill* is not applicable" to state income taxation. *See Couchot*, 659 N.E.2d at 1230; *see also id.* at 1230-31 (physical presence test would "in any event have been satisfied" had it been applicable).

State appellate court decisions rendered in several other States have also held that the physical presence requirement for "substantial nexus" under the Commerce Clause applies only in cases involving sales and use taxes. *See Kmart Props., Inc. v. Taxation & Revenue Dep't of N.M.*, 131 P.3d 27, 35 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22 (N.M. 2005); *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 194-195 (N.C. 2004), *certif. denied*, 611 S.E.2d 168 (N.C.), *cert. denied*, 126 S. Ct. 353 (2005); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632, 638 (Okla. Civ. App. 2005); *Gen. Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1029 (Wash. App.), *pet. rev. denied en banc*, 84 P.3d 1230 (Wash. 2001), *cert. denied*, 535 U.S. 1056 (2002).

Finally, some other States have amended their statutes, promulgated regulations, or issued other directives that assert authority to tax corporations that lack a physical presence in the State, thereby restricting *Quill's* physical presence requirement to sales and use taxes. *See, e.g.*, Ark. Reg. 1996-3 (licensing of intangibles in an intragroup intangible licensing transaction creates nexus); Fla. Admin. Code Ann. r. 12C-1.011 (p)1 (2007) (selling or licensing the use of intangibles creates nexus); Iowa Admin. Code r. 701.52.1(422), 52.1(1)d (2007) (citing *Geoffrey* and providing that licensing intangibles to corporations doing business in Iowa creates nexus);

Directive 96-2 (Mass. Dep't of Revenue July 3, 1996) (licensing of intangibles for use in Massachusetts creates nexus); Minn. Stat. § 290.015(1)(c)(3) (2005) (providing that business within Minnesota includes transactions with customers in the State that involve intangible property and results in receipts attributable to Minnesota); Okla. Admin. Code § 710:50-17-3(a)(9) (2005) (licensing of intangible rights for use in Oklahoma creates nexus); Wis. Admin. Code Tax § 2.82(4)9 (2007) (licensing of intangible rights for use in Wisconsin creates nexus).

C. Certiorari Should Be Granted Now To Resolve This Important Conflict.

The States are thus conclusively divided on the question presented; there is no prospect that the conflict will resolve itself absent this Court's intervention. Nor is there any reason to await further development of the conflict, for the split in authority concerning the Commerce Clause has already had serious adverse consequences for taxpayers and taxing authorities alike. Taxing officials in the various States have been held to have different scopes of taxing authority and out-of-state businesses with no physical presence within taxing States are subject to different taxing regimes.

Uncertainty inhibits business planning and investment and is extraordinarily costly from a fiscal and societal vantage point. Federal courts, of course, are generally barred by the Tax Injunction Act from adjudicating the constitutionality of state taxes. *See* 28 U. S. C. § 1341. Thus, absent this Court's review, this patchwork of state court decisions and state regulations construing the federal Constitution will continue – without any federal judicial guidance. If businesses – both domestic and foreign – that lack physical presence in a State need not pay state income and franchise taxes, those businesses should know that. And if state taxing authorities have the power to impose taxes in the absence of physical presence – particularly those who are not exercising that

power in the belief that *Quill* forbids it – those authorities should know that, too.

The need for clarity on this topic is especially pressing in light of new requirements of corporate transparency in accounting. The new Financial Accounting Standards Board Interpretation No. 48 (FIN 48), entitled Accounting for Uncertainty in Income Taxes, prescribes how a company must measure, and disclose in its financial statements, the tax positions that the company has taken, including decisions whether or not to file a return in particular jurisdictions.[6] FIN 48 requires a company to measure and disclose whether it is "more likely than not" that each taxing authority will conclude (based on the position's technical merits) whether the company is required to pay taxes in that State, without consideration of the likelihood that the taxing authority will examine the company's position. Unless a company can show that the taxing authority would, more likely than not, sustain the company's position that it need not file a return, "the company would be required to recognize a FIN 48 liability, interest, and, potentially, penalties" in its financial statements. Charles E. Berg, Practising Law Institute, Preparation of Annual Disclosure Documents 2007: PricewaterhouseCoopers Datalines Regarding Hot Button Accounting Issues, No. 2006-18 (Jan. 2007). If there is uncertainty about whether the State is correct or the taxpayer is correct, the taxpayer's decision not to file a tax return "would prevent the statute of limitations from kicking in, and thus the FIN 48 liabilities [on its financial statement] would possibly never reverse, and interest would accrue [on the financial

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[6] This interpretation became effective for fiscal years beginning after Dec. 15, 2006, and public companies must abide by that interpretation in preparation of their financial statements filed with the Securities and Exchange Commission. *See* SEC, Codification of Financial Reporting Policies § 101, reprinted at 7 Fed. Sec. L. Rptr. (CCH) ¶72,921.

statement] in perpetuity." *Id.* Uncertainty about the requirements of the law in this area thus could have profound consequences for the publicly reported financial health of a corporation, and for shareholder value, the ability to raise capital, and so on.

This issue also has implications even beyond our national borders. Under most of the more than fifty bilateral tax treaties to which the United States is a party, the United States has agreed to tax foreign corporations only if they have a "permanent establishment" in the United States, which is normally defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." The federal government's support of the "permanent establishment" concept is most recently reflected in Article V of the Model Income Tax Convention of November 15, 2006, issued by the U.S. Department of Treasury, available at www.ustreas.gov/press/releases/reports/hp16801.pdf (last visited March 5, 2007), which the government uses as a basis for all tax treaty negotiations. These treaties are of particular concern here because they generally do not constrain the power of States and localities to impose taxes on foreign corporations. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-197 (1983); Jerome B. Libin & Timothy H. Gillis, *It's a Small World After All: The Intersection of Tax Jurisdiction at International, National, and Subnational Levels*, 38 Ga. L. Rev. 197, 254-255 (2003). Consequently, if the decision below is permitted to stand, a foreign corporation without a "fixed place of business" in the United States may find itself subject to tax by States that reject a physical presence requirement, even though the foreign corporation would not be subject to federal income tax based on a bilateral treaty. New Jersey, in fact, has already begun circulating nexus surveys to foreign affiliates of domestic corporations. *See, e.g.*, State of New Jersey Nexus Survey (July 17, 2006), available at http://www.ofii.org/njltr.pdf (last visited March 5, 2007). This substantial risk of divergent treatment by federal and state tax authorities is contrary

to the important federal interest underlying U.S. tax treaties, which is to protect U.S. businesses from overly burdensome foreign taxation by ensuring that both the United States and its trading partners assert taxing authority on generally the same terms.

II. THE DECISION BELOW IS WRONG AND CONFLICTS BOTH WITH THIS COURT'S COMMERCE CLAUSE DECISIONS AND WITH THE PRINCIPLES OF FEDERALISM THEY REFLECT.

A. This Court's Commerce Clause Precedents Do Not Distinguish Among Types Of State Taxes.

The courts that have limited the *Bellas Hess/Quill* physical-presence requirement to sales and use taxes – including the court below, *see* App. 3a – have relied heavily on the observation in *Quill* that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement." 504 U.S. at 314. That phrase, as Respondent's argument here will likely reflect, has played a critical role in the widespread controversy discussed in this Petition – which is all the more reason this Court should revisit the issue to clarify the implications of its own dictum. In fact the dictum has been fundamentally misread by the lower courts that have relied on it. Those courts have used it as license to hold what there is no principle to support, i.e., that sales and use taxes differ materially from income and franchise taxes for purposes of the Commerce Clause. There is simply no basis in precedent or logic for such a distinction.

The basic Commerce Clause rule has always been a general one: "[T]he interstate business must have a substantial nexus with the State before *any tax* may be levied on it." *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 626 (1981) (emphasis added). This Court set forth the analysis that includes the "substantial nexus" requirement in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a case involving sales tax. But *Complete Auto* itself relied on franchise tax precedent. *See id.* at 285-287 (citing *Colonial*

Pipeline Co. v. Traigle, 421 U.S. 100, 101 (1975)). And the Court noted in *Complete Auto* that its analysis had been applied by the Court to "many types of tax." 430 U.S. at 279. This Court has subsequently used the same analysis to assess the constitutionality of state income taxes under the Commerce Clause. *See, e.g., Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 311 & n.10 (1994); *Amerada Hess Corp. v. Dir., Div. of Taxation*, 490 U.S. 66, 73 (1989).[7]

More generally, the Court in *Complete Auto* emphasized that the label given to a tax will not result in different analyses or results under the Constitution. "A tailored tax, *however accomplished*, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." 430 U.S. at 289 n.15 (emphasis added). Accordingly, in discussing the Commerce Clause nexus requirement, this Court has routinely referred to cases involving sales and use taxes interchangeably with cases involving direct taxes such as income and franchise taxes, undermining the idea that there are different nexus requirements for different kinds of taxes. *See, e.g., National Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 555-59 (1977).

Whether a State imposes an obligation to collect sales and use taxes on gross receipts from in-state customers, or a direct tax on the profits or earnings realized from those gross receipts, the taxes are essentially indistinguishable in their economic effects. There certainly is no logical reason a State that cannot under the Commerce Clause impose sales and use taxes upon out-of-state companies with no physical presence in the State should be able to impose income and fran-

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[7] Indeed in the *Barclays Bank* case the Court specifically noted in the course of finding that a State's imposition of an income tax met the substantial nexus standard that *Quill*'s physical presence requirement was satisfied. See *Barclays Bank*, 512 U.S. at 311 n.10.

chise taxes upon them. No court has been able to demonstrate otherwise.

Indeed, as this Court has explained, if anything, the economic burdens upon interstate commerce of income taxes on interstate businesses are actually *greater* than the consequences of sales and use tax collection obligations. *See National Geographic*, 430 U.S. at 558. The laws invalidated in *Bellas Hess* and *Quill* were not direct taxes on out-of-state entities, but were obligations to collect sales and use taxes from in-state customers. By contrast, income and franchise taxes are *direct* taxes imposed upon the out-of-state entity. Whereas a collection obligation generally imposes only the administrative burden of collecting the tax at the point of sale, a direct tax imposes both administrative burdens *and* immediate financial obligations. *Id.* It also exacerbates the risk of double taxation, a serious and unfair financial burden. *Id.*[8]

Moreover, the complexity and burden of complying with corporate income and franchise taxes are greater than the

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[8] Nor of course is there any bright line between what might be denominated "sales and use" taxes on the one hand, and what might be denominated "franchise and income" taxes on the other. Taxes on "gross receipts," for example, could be described as taxes on sales within the State, or as taxes on income received outside the State. States have sometimes been quite skillful at using labels to attempt to avoid restrictions on their taxing power. In situations where States have determined that it was advantageous to have a tax not be considered a "net income tax" in order to avoid restrictions imposed by Congress in Pub. L. 86-272, which prohibits imposition of state "net income taxes" based solely upon solicitation of orders in-state for sales of tangible personal property, the States have deftly avoided the congressional limitation. *See* Pub. L. 86-272, 73 Stat. 555, codified at 15 U.S.C. §381. For example, New Jersey has enacted an "alternative minimum assessment," a component of its corporation business tax, which is computed on gross receipts or gross profits, and it now is applied only to entities that claim protection against state income taxes under Pub. L. 86-272. *See* N.J. Stat. Ann. § 54:10A-5a.e (2007).

complexity and burden of sales and use tax compliance. Income tax compliance involves apportionment formulae, sourcing and inclusion definitions, legal entity classification, classification of income, depreciation, disclosure requirements, and other elements. And each of these elements could and likely would vary among the thousands of potential direct taxing jurisdictions. As a result, abandoning the physical presence test and permitting States and localities to impose broad income and franchise tax liability will force businesses to confront and comply with a bewildering array of differing rules that would generate enormous compliance costs. The costs are at least as burdensome as those that would be involved if the States were allowed to impose sales and use tax collection and remittance obligations.

And, as the Court in *Quill* recognized, the increased compliance obligations created by relaxed nexus requirements for any tax necessarily increase the burden on interstate commerce. This Court noted the broad burden that would have been imposed by the North Dakota law struck down in *Quill* which would have imposed a tax collection duty on every vendor who advertised in the State three times in a single year. 504 U.S. at 313 n.6. New Jersey would impose its tax obligation at least as broadly: a New Jersey statute purports to impose its CBT as broadly as is permitted by the federal Constitution. N.J. Stat. Ann. § 54:10A-2 (2007) ("A taxpayer's exercise of its franchise in this State is subject to taxation in this State if the taxpayer's business activity in this State is sufficient to give this State jurisdiction to impose the tax under the Constitution and statutes of the United States."). Even "more significant" to the *Quill* Court than the breadth of the taxing obligation imposed by the State before it was the fact that "similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions." 504 U.S. at 313 n.6. The same is true here: absent a physical presence rule, businesses may be subject to income, franchise or gross-receipts taxes wherever they have customers in any of the over 8,000 jurisdictions in the United States

that are authorized to impose such taxes. *See* Ernst & Young, E Tax Alert, Quantitative Economics and Statistics; State and Local Taxation (March 7, 2007) available through http://www.ey.com/global/content.nsf/US/Tax_-_Quantitative_Economics_and_Statistics_-_Overview (indicating number of jurisdictions authorized to impose such taxes).

B. The Bright-Line, Physical-Presence Requirement Provides A Judicially Manageable Default Rule.

The physical presence test provides what this Court has described as a "bright-line" rule, which "encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Quill*, 504 U.S. at 316. Equally important, the bright-line, physical-presence requirement is both principled and judicially manageable.

The courts rejecting a physical presence requirement for income and franchise taxes have used varying formulations for the tests that replace it, but none provides any principled, judicially manageable limitation on state authority to tax. The West Virginia Supreme Court's decision in *MBNA* adopts a general "significant economic presence" test, i.e., the State may tax any business with a significant economic presence in the State. Other state appellate court decisions have applied similarly vague tests based on economic presence or commercial activity within the State. *See*, *e.g.*, *Gen. Motors*, 25 P.3d at 1028-29. By contrast, other state-court decisions – including the New Jersey decision below – have adopted what may at first blush appear to be a more limited exception to the physical presence rule, holding at least that that the licensing of "intangible property" for use within a State creates a "presence" that is a sufficient nexus for taxing power under the Commerce Clause. *See* App. 13a-20a;

Geoffrey, 437 S.E.2d at 18; *A&F Trademark*, 605 S.E.2d at 195.[9]

These lines are unprincipled and provide no guidance to the judges who would have to apply them. None is rooted in constitutional principle – no one believes the Commerce Clause is peculiarly concerned with sales and use taxes – and each would permit a State to regulate all interstate commerce involving a customer who lives within the State. Just as the reading of the Commerce Clause proposed in *United States v. Lopez*, 514 U.S. 549 (1995), had no clear stopping point with respect to federal power, *see also infra* at 25-26, elimination of the requirement of physical presence within those borders would effectively eliminate all judicially manageable restrictions upon a State's power to reach beyond its borders to tax interstate commerce.

The "intangible presence" test suggested by the South Carolina Supreme Court in *Geoffrey* and to which the New Jersey Supreme Court below referred provides no limit to state authority because a license for use of intangible property ultimately is indistinguishable from any other commercial sale, license, contract, or other transaction with an in-state resident. *See infra* at 26-28. The contractual right to

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[9] Several decisions rejecting the physical presence requirement involved out-of-state entities in commercial relationships with affiliated in-state entities that paid licensing or other fees to the out-of-state entities, and at least one decision specifically relied on the affiliations as establishing a substantial nexus between the State and the out-of-state entity. *See A&F Trademark*, 605 S.E.2d at 195. Properly understood, this is irrelevant to the constitutional calculus. If a State is concerned about payments by an in-state entity to an out-of-state affiliate based on a belief that the affiliate is some type of sham or there is not, in fact, an arms-length relationship, that concern is properly addressed by the State through examination of the tax liability and returns of the in-state entity. Such a concern does not warrant elimination of the constitutional boundary between what a State may regulate beyond its borders and what it may not.

use intellectual property is no different from the contractual right to receive a product purchased by mail order or online transaction, *see Quill*. The universe of potential taxpayers is therefore the universe of companies that have customers in the taxing State. Likewise, the "economic presence" test articulated by the West Virginia Supreme Court of Appeals in *MBNA* imposes no restraint on state power to tax interstate commerce. All out-of-state companies that sell goods and services to customers in-state have an "economic presence."

A court could in theory impose some limit on the taxing power under these standards, but only by making an artificial determination of what kind and what degree of economic contact with a State, or of what intangible property present in the State, is sufficient to create a "substantial nexus." The articulation of those unprincipled lines, however, would involve an inherently legislative judgment.

It is precisely the genius of this Court's Commerce Clause holdings in *Bellas Hess* and *Quill* that they do not attempt to make this inherently legislative determination themselves, but rather leave Congress with the power to craft a different rule if one is desirable. *Cf. Quill*, 504 U.S. at 320 (Scalia, J. concurring in part and concurring in judgment) (noting that these decisions' claim to *stare decisis* effect has "special force" because of Congress's power to alter them). Unlike the Court, if the Congress rejects physical presence as a requirement for state taxation of out-of state companies, it need not replace it with an unmanageable alternative nor need it be concerned with whether its actions are properly animated by consistent constitutional principle. Congress may craft a nuanced approach that it believes meets the nation's needs and addresses whatever concerns exist about requiring physical presence for taxation. Congress even could carve out *ad hoc* exceptions from the physical presence rule if it were to find the need. This is a task to which the courts are by definition not suited.

C. The Physical-Presence Test Reflects And Reinforces The Structure Of Our Federal System.

Finally, the physical-presence rule is animated by principles of federalism, which divides authority both between the States and the federal government, and among the individual States.

The modern economy may lack borders, but States do not. Indeed, if state boundaries mean nothing, then States mean nothing: the only thing that distinguishes one political entity called a "State" from another in our federal system is the geographic boundaries that define them. Since *Quill*, this Court has emphatically reaffirmed the constitutional significance of the States' geographical boundaries. It has reiterated the Constitution's structural limitations on the States' power to regulate beyond their borders, *see State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 421 (2003); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 569-71 (1996), as well as the Commerce Clause's limitations on Congress's power to regulate certain activities having impacts only within those state boundaries, *see United States v. Lopez*, 514 U.S. 549, 567 (1995).

The Commerce Clause requirement of physical-presence is a reflection of the same geographical principle underlying these precedents. Physical borders are the necessary limit of a State's authority to tax. As Justice Kennedy wrote for the Court in 1992: "In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation." *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777-778 (1992). By the same token, "[T]he theory that two governments accord more liberty than one requires for its realization two distinct and discernable lines of political accountability: one between the citizens and the Federal Government; the second between the citizens and the States. . . . Our position in enforcing the dormant Commerce Clause is instructive. . . . One element

of our dormant Commerce Clause jurisprudence has been the principle that the States may not impose regulations that place an undue burden on interstate commerce, even where those regulations do not discriminate between in-state and out-of-state businesses." *Lopez,* 514 U.S. at 576-580 (Kennedy, J., concurring).

By giving decisive weight to the taxpayer's physical presence within state borders, the rule of *Bellas Hess* and *Quill* respects and reinforces the very concept of the State itself. By contrast, if the physical presence of taxpayers becomes irrelevant to a State's power over them, and a State is allowed to exert broad taxing authority solely on the basis of activity in commercial markets that are by now essentially borderless and worldwide, then state power becomes effectively unmoored from the very feature of the State that gives it constitutional status, i.e., its sovereignty over a specified geographical area and those who come within it.

D. The Idea That the Use in a Particular State by a Licensee of a Business's Intangible Property Alone Constitutes a "Presence" of that Business in that State Does Not Provide a Principled Distinction from Instances Where Physical Goods Alone are Shipped into a State.

The decision below permits taxation of income of a company with no in-state physical presence where that company's intangible property is being used by someone else within the State who has licensed it. As described above, decisions on which the courts below relied asserted that because companies like Petitioner license intellectual property, their "intangible property" is "present" in the State in which the licensee uses it in a way that differentiates them from sellers like those in *Quill* whose physical goods are shipped into the State. App.19a. In fact, the transactions at issue here are indistinguishable in principle from the transactions at issue in *Quill* which the Court found insufficient to establish a "substantial nexus" with the taxing State. The fact that

they involve intangible intellectual property is immaterial to the Commerce Clause question.

To begin with, by its nature intangible property "ha[s] no actual territorial situs." *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 211 (1930). It is true that it is sometimes said to have a situs for tax purposes, but the situs generally follows the person who owns it or, in some cases, the activities in which he or she is engaged. *Curry v. McCanless*, 307 U.S. 357, 368 (1939). In this case, of course, Petitioner has no presence in and has conducted no activities in the taxing State.

More fundamentally, the transactions at issue in a case like this – the sale by an out-of-state company of a license to intellectual property for its use by an in-state customer – are economically identical to the transactions at issue in *Bellas Hess* and *Quill*: the sale by an out-of-state company of goods for use by an in-state customer. The use of Petitioner's trademark inside the taxing State by the customers who licensed it is indistinguishable from the use in *Bellas Hess* and *Quill* of the mail order house's goods inside the taxing State by the customers who purchased them. And those cases make clear that the sale of goods and services within a State is not an adequate basis for imposing tax on an out-of-state entity with no in-state physical presence.

Unsurprisingly, the idea that a licensee's use of a corporation's intangible property in a taxing State could be equated for Commerce Clause purposes with physical presence of that corporation sufficient to permit state taxation was woven from whole cloth. The idea was conceived by the *Geoffrey* court, which asserted incorrectly that "[i]t is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus." *Geoffrey*, 437 S.E.2d at 18. That is simply false: In support of the proposition *Geoffrey* cited a single New Mexico state case that did not even discuss intangible property in the con-

text of the nexus requirement under the Commerce Clause, *Am. Dairy Queen Corp. v. Taxation & Revenue Dep't*, 605 P. 2d 251, 255 (N.M. Ct. App. 1979).[10]

Nor has this Court in its modern Commerce Clause jurisprudence ever allowed intangible property alone to form a basis for state taxation. The Petitioner in *Quill* could be said to have had "intangible property" with a "legal situs" in the taxing State: its "going concern value" calculated based on its gross receipts from sales in that State. *See Complete Auto*, 430 U.S. at 284 (describing a tax on such intangible property). Yet in *Complete Auto*, this Court rejected precisely the approach that permitted taxation on the basis of the presence of such property where it was otherwise forbidden by the Commerce Clause. The fact that this case involves intangible intellectual property thus can do nothing to eliminate the conflict with the decisions of this Court.

III. THIS COURT SHOULD AGAIN INTERVENE TO PROTECT THE FREE FLOW OF INTERSTATE COMMERCE.

This is not the first time this Court's intervention in this context has been necessary. The law challenged in this case is part of a third wave of state tax laws that have targeted

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[10] *Geoffrey* also said that a "taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business." *Geoffrey*, 437 S.E.2d at 18 (citing *Curry v. McCanless*, 307 U.S. 357, 368 (1939)). This confuses the question of "the guidelines necessary to circumscribe the reach of the State's legitimate power to tax," with "[t]he constitutional question . . . whether the State has the authority to tax the corporation at all." *Allied-Signal*, 504 U.S. at 778. But in any event, *Curry*, a Fourteenth Amendment case, actually holds that intangibles may be taxed in the State where their owner conducts "his activities." 307 U.S. at 367. This is essentially a restatement of the physical presence test, *see supra* at 2 n.1. Only the in-state conduct or presence of the *owner* of the intangibles – here, Petitioner – can provide the constitutionally required nexus for state taxation.

nonresidents in order to enrich state fiscs. The constitutionality of the first wave of laws was resolved by this Court in *Bellas Hess*, when the Court held that the physical presence of a company in a State is required before that State can require a company to collect and remit use taxes to the State.

By 1992, however, 34 States had amended their tax statutes to impose tax collection obligations upon out-of-state direct marketers and, despite the clear prohibition on such taxation set out in *Bellas Hess*, state courts were sustaining the constitutionality of those state laws. That second wave of laws resulted in this Court's invalidation of such laws and affirmation of the *Bellas Hess* physical presence nexus standard under the Commerce Clause in *Quill*.

Now, the constitutionality of a third wave of laws is being litigated throughout the country. And while the Court in *Quill* was concerned with the effect of state taxes on the reliance interests of the mail-order industry, today's economy includes a much broader and even more vital sector of e-commerce businesses that has developed in reliance on the physical presence rule.

Yet the States' arguments today are the same as those made and rejected in *Quill*.[11] The state courts have issued irreconcilable decisions. The disputes have been costly, time-consuming and, because of the high financial stakes, will continue unabated until this Court grants review. Al-

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[11] North Dakota's arguments in *Quill* included assertions that the business had made a lot of money from in-state customers and should have paid tax to that State on that income; that the business had been provided benefits by the State; that the business would be at a competitive advantage to in-State merchants who necessarily must collect the tax; that *Bellas Hess* was repudiated by this Court's decision in *Complete Auto*, and that *Bellas Hess* was rendered obsolete by the technological and economic changes of the late twentieth century. *See also MBNA*, 640 S.E. 2d at 241 (Benjamin, J., dissenting) (this Court squarely rejected "economic exploitation nexus" arguments in *Bellas Hess* and *Quill*).

though many problems of such magnitude are not easily resolved, this Court has the power and ability to address this one and to ensure that the integrity of the judicial process is not eroded, reliance interests are respected, and the clarity provided by the *Bellas Hess/Quill* rule is restored for this country's business community and tax agencies.

In addition to this Petition, the Court currently has before it a Petition for Certiorari in the *MBNA* case. That decision is a concrete demonstration that the States' abandonment of the physical presence rule has expanded well beyond cases involving intangible property licensees, and now includes virtually every type of business. If the court were inclined to review only one of the two cases, and chose to grant certiorari in *MBNA* because it is arguably more broadly applicable, it should hold this case pending disposition of *MBNA*. In our view, however, the Court, the States, and the substantial interests of businesses operating in interstate commerce throughout the country would be best served by granting both Petitions, hearing the cases in tandem, and affirming the continuing vitality of the physical presence rule.

CONCLUSION

The Petition for a writ of Certiorari should be granted.

Respectfully submitted,

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March 9, 2007

APPENDIX

APPENDIX TABLE OF CONTENTS

APPENDIX A

Decision of the Supreme Court of New Jersey 1a

APPENDIX B

Decision of the Superior Court of New Jersey Appellate Division 4a

APPENDIX C

Decision of the Tax Court of New Jersey 21a

APPENDIX D

Relevant New Jersey Statutory and Regulatory Provisions 43a

APPENDIX E

Joint Stipulation of Facts..... 51a

APPENDIX A

SUPREME COURT OF NEW JERSEY
A-89 September Term 2005

LANCO, INC.,
a Delaware corporation,

Plaintiff-Appellant,

v.

DIRECTOR, DIVISION OF
TAXATION,

Defendant-Respondent.

Argued September 12, 2006 – Decided October 12, 2006

On appeal from and certification to the Superior Court, Appellate Division, whose opinion is reported at 379 *N.J. Super.* 562 (2005).

Paul H. Frankel, New York City, argued the cause for appellant (McCarter & English, attorneys; *Mr. Frankel*, and *Michael A. Guariglia*, of counsel and on the brief).

Patrick DeAlmeida, Assistant Attorney General, argued the cause for respondent (*Anne Milgram*, Acting Attorney General).

Francis X. Manning, submitted a brief on behalf of *amicus curiae* The Investment Company Institute (Stradley Ronon Stevens & Young, attorneys).

Sheldon H. Laskin, submitted a letter in lieu of brief on behalf of *amicus curiae* Multistate Tax Commission.

PER CURIAM

This appeal involves the issue of whether New Jersey may constitutionally subject a foreign corporation to the Corporation Business Tax, *N.J.S.A.* 54:10A-1 to -41, when the corporation lacks physical presence in New Jersey but derives income through a licensing agreement with a company conducting retail operations in New Jersey. The Appellate Division answered that question affirmatively. *Lanco, Inc. v. Director, Div. of Taxation*, 379 *N.J. Super.* 562, 573 (2005). We agree and affirm substantially for the reasons expressed in Judge Stern's thorough and thoughtful opinion. We write only to add the following brief comments.

In *Quill Corp. v. North Dakota*, 504 *U.S.* 298, 112 *S. Ct.* 1904, 119 *L. Ed.* 2d 91 (1992), the United States Supreme Court affirmed the four-part standard it created in *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274, 97 *S. Ct.* 1076, 51 *L. Ed.* 2d 326 (1977), for cases involving Commerce Clause challenges to state taxation. In that case, the Court determined that, in the context of sales and use taxes, an entity must be physically present in the taxing jurisdiction to establish the constitutionally required "substantial nexus." *Quill, supra*, 504 *U.S.* at 311- 17, 112 *S. Ct.* at 1914-16, 119 *L. Ed.* 2d at 105-10. Since the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court's holding was limited to sales and use taxes. *See, e.g., A & F Trademark, Inc. v. Tolson*, 605 *S.E.*2d 187, 193-96 (N.C. Ct. App. 2004) (holding North Carolina can impose corporate franchise and income taxes on companies not physically present in North Carolina), *certif. denied*, 359 *N.C.* 320, *cert. denied*, ___ *U.S.* ___, 126 *S. Ct.* 353, 163 *L. Ed.* 2d 62 (2005); *J.C. Penney Nat'l Bank v. Johnson*, 19

*S.W.*3d 831, 838-39 (Tenn. Ct. App. 1999) (holding Tennessee cannot impose franchise and excise tax on company not physically present in Tennessee), *cert. denied*, 531 *U.S.* 927, 121 *S. Ct.* 305, 148 *L. Ed.* 2d 245 (2000).

We believe that the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes. That interpretation reflects the language of *Quill*. In *Quill*, the Court did not attempt to equate the substantial-nexus requirement with a universal physical-presence requirement. *See id.* at 314, 112 *S. Ct.* at 1914, 119 *L. Ed.* 2d at 108 ("[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes. . . ."). Rather, the Court carefully limited its language to a discussion of sales and use taxes. *See, e.g., id.* at 316, 112 *S. Ct.* at 1915, 119 *L. Ed.* 2d at 109 (acknowledging benefits of imposing bright-line rule "in the area of sales and use taxes"). Simply put, we do not believe that the Supreme Court intended to create a universal physical-presence requirement for state taxation under the Commerce Clause. We therefore affirm the Appellate Division's determination that the Director constitutionally may apply the Corporation Business Tax notwithstanding a taxpayer's lack of a physical presence in New Jersey, and we further affirm the Appellate Division's remand of this matter to the Tax Court for additional proceedings.

JUSTICES LONG, ZAZZALI, LaVECCHIA, ALBIN, WALLACE, and RIVERA-SOTO join in this per curiam opinion. CHIEF JUSTICE PORTIZ did not participate.

APPENDIX B

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3285-03T1

LANCO, INC.
a Delaware corporation,

Plaintiff-Respondent,

v.

DIRECTOR, DIVISION OF
TAXATION,

Defendant-Appellant.

Argued March 3, 2005 – Decided August 24, 2005

Before Judges Stern, Wecker and Graves.

On appeal from a final judgment of the Tax Court of New Jersey, Docket No. 5329-1997,whose opinion is reported at 21 *N.J. Tax* 200.

Patrick DeAlmeida, Deputy Attorney General, argued the cause for appellant (Peter C. Harvey, Attorney General, attorney; Michael J. Haas, Assistant Attorney General, of counsel; Mr. DeAlmeida, on the brief).

Paul H. Frankel, argued the cause for respondent (McCarter & English and Morrison & Foerster of the New York bar, attorneys; Hollis L. Hyans, Craig B. Fields, Amy F. Nogid, Charles M. Costenbader and Mr. Frankel, on the brief).

Stradley Ronon Stevens & Young, attorneys for amicus curiae The Investment Company Institute (Stephen B. Nolan, on the brief).

Rene Y. Blocker, Deputy Director, attorney for amicus curiae Multistate Tax Commission (Mr. Blocker and Sheldon H. Laskin, Director Nexus Program, on the brief).

The opinion of the court was delivered by

STERN, P.J.A.D.

This case presents the important question, as the Tax Court stated it, of "whether New Jersey may constitutionally subject a foreign corporation to the Corporation Business Tax (*N.J.S.A.* 54:10A-1 *et seq.*, 'the CBT'), where the corporation has no physical presence in the state and derives income from a New Jersey source only pursuant to a license agreement with another corporation that conducts a retail business here." *Lanco, Inc. v. Director, Div. of Taxation*, 21 *N.J. Tax* 200, 203 (Tax 2003).

Defendant, Director of the Division of Taxation, appeals from an order of January 9, 2004, entering judgment for plaintiff taxpayer "since it does not have a taxable nexus in the State which would subject it to New Jersey's Corporate Business Tax." Plaintiff, which licenses intellectual property (trademarks, trade names and service marks) to Lane Bryant, a clothing retailer, has no real or personal property or personnel in the State, and the Tax Court, in a published opinion, held that because plaintiff was not physically present in New Jersey, subjecting it to the tax would violate the Commerce Clause of the federal constitution. *Lanco*, *supra*, 21 *N.J.* [*Tax*] at 214. On this appeal the Director argues that Lanco derived receipts from sources in the State, thereby making it subject to the tax, and that "there are no

constitutional impediments to application of the corporation business tax to plaintiff given its substantial nexus to New Jersey" because there was no violation of the due process clause (which is not contested before us)[1] or the Commerce Clause (which is the critical issue contested on the appeal). Thus, the critical issue is whether the taxpayer must have a physical presence in the state in order to constitute the required "substantial nexus" necessary to satisfy the Commerce Clause under *Quill Corp. v. North Dakota*, 504 *U.S.* 298, 112 *S. Ct.* 1904, 119 *L. Ed.* 2d 91 (1992), which applied that test and held physical presence was necessary in the context of a sales and use tax.

The Tax Court succinctly stated the relevant facts as follows:

> Plaintiff Lanco, Inc., ("Lanco") is a Delaware corporation that owns certain intangible property (trademarks, trade names and service marks). The parties have stipulated that Lanco has no offices, employees, or real or tangible property in New Jersey. Lanco licenses Lane Bryant, Inc., ("Lane Bryant") to utilize the intangible property in the conduct of Lane Bryant's retail operations, including those in New Jersey, and in return receives royalty payments from Lane Bryant. Lanco and Lane Bryant are affiliated corporations, but the common ownership is not material to the constitutional issue concerning the determination by the defendant, Director of the Division of Taxation

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[1] We need not comment on the Tax Court's thorough and well reasoned analysis of the Due Process issue, *see Lanco, supra,* 21 *N.J. Tax* at 214-17, as plaintiff does not endeavor to defend the judgment on due process grounds.

> ("Director"), that activity under the license agreement makes Lanco subject to taxation in New Jersey. It is the determination that Lanco is obliged to file under the CBT, rather than the calculation of tax claimed to be due, that is contested.
>
> [*Lanco*, *supra*, 21 *N.J. Tax* at 203 (footnote omitted).]

In *Quill Corp. v. North Dakota*, 504 *U.S.* 298, 301, 112 *S. Ct.* 1904, 1907, 119 *L. Ed.* 2d 91, 99 (1992), the State of North Dakota sought to impose a duty to collect a use tax on "an out-of-state mail-order house that ha[d] neither outlets nor sales representatives in the State." Quill sold office furniture by mail order catalogue and advertising, and delivered it by mail or common carrier. The Court held that, while the Due Process Clause "minimum contacts" jurisprudence did not bar the state from requiring Quill, as the seller, to collect a use tax, there was an insufficient nexus under the Commerce Clause to permit such a tax. *Quill*, *supra*, 504 *U.S.* at 313, 112 *S. Ct.* at 1913-14, 119 *L. Ed.* 2d at 101. According to Justice Stevens, "[t]he two standards are animated by different constitutional concerns and policies":

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual

> defendant as by structural concerns about the effects of state regulation on the national economy.
>
> [*Quill, supra*, 504 *U.S.* at 312, 112 *S. Ct.* at 1913, 119 *L. Ed.* 2d at 106.]

The Court discussed the four factors it first enunciated in *Complete Auto Transit, Inc. v. Brady*, 430 *U.S.* 274, 279, 97 *S. Ct.* 1076, 1079, 51 *L. Ed.* 2d 326, 331 (1977), to determine whether a state tax will withstand a commerce clause challenge:

> Under *Complete Auto*'s four-part test, we will sustain a tax against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State."
>
> [*Quill, supra*, 504 *U.S.* at 311, 112 *S. Ct.* at 1912, 119 *L. Ed.* 2d at 105.]

In discussing the four factors the *Quill* Court explained that "[t]he second and third parts of that analysis, which require fair apportionment and non-discrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce." *Quill, supra*, 504 *U.S.* at 313, 112 *S. Ct.* at 1913, 119 *L. Ed.* 2d at 107. "The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." *Ibid.* The Court stated:

> Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, . . . a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause.

[*Quill*, *supra*, 504 *U.S.* at 313, 112 *S. Ct.* at 1913-14, 119 *L. Ed.* 2d at 107 (footnote omitted).]

Accordingly, for purposes of the Commerce Clause, the *Quill* court maintained the "bright-line, physical-presence requirement [established by *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 *U.S.* 753, 87 *S. Ct.* 1389, 18 *L. Ed.* 2d 505 (1967), for imposition] of sales and use taxes." *Quill*, *supra*, 504 *U.S.* at 317, 112 *S. Ct.* at 1916, 119 *L. Ed.* 2d at 110.[2]

The Director argues that "the rationale for abandoning a physical-presence requirement for Due Process Clause purposes recognizes that businesses engage in significant levels of commercial activity in a state without ever 'setting foot' there," and businesses foresee being subject to state tax laws as a result of commercial activity directed at a particular state. The Director further contends that "[t]here is no principled reason why the Commerce Clause should require a corporation's physical presence to justify State taxation . . . provided the State can establish that the corporation derives

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[2] As will be further developed hereinafter, a careful reading of *Quill* reflects the express limitation for sales and use taxes as a matter of *stare decisis* in light of *Bellas Hess*, even though "the *Bellas Hess* rule appears artificial at its edges." *Quill*, *supra*, 504 *U.S.* at 315, 112 *S. Ct.* at 1914, 119 *L. Ed.* 2d at 108.

significant benefits from continued and deliberate economic activity in the taxing State." The Director also emphasizes that *Quill* involved vendors whose only connection with customers was by common carrier or the United States mail, but here there is a long-term contractual relationship with a related corporation that operates retail-clothing outlets throughout New Jersey.

Defendant further asserts that the agreement between plaintiff and Lane Bryant "promotes increased retail purchases of merchandise" at stores in New Jersey, and that "growth in retail sales burdens [New Jersey] by increasing traffic, requiring police and fire protection, and imposing demands on the labor pool."[3] Defendant therefore argues that this case is distinguishable from *Quill* and *Bellas Hess*, on which *Quill* relied, where they merely sent mail order catalogs into a state without obtaining the benefits and protection of state services and labor which derive from its physical presence. In this case, the Director maintains that plaintiff and its related entity, Lane Bryant, enjoy numerous benefits provided by New Jersey including: (1) "protection afforded by the New Jersey judiciary to [plaintiff 's] rights under the licensing agreement and its right to protect its trademarks and service marks"; (2) maintenance of New Jersey's highway system and production of an "educated workforce"; and (3) "police, fire and judicial protection" of

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[3] Many facts were stipulated, and we rely on the Tax Court's recitation of facts. Because we reverse the Tax Court on the Commerce Clause holding (and merely address the fundamental issue presented), we will allow further development before that court of any remaining relevant or material factual contest which may affect the taxability, determination of apportionment of income attributable to New Jersey, or tax for any particular tax year in question.

the physical property upon which Lanco's trademarks are used, even if owned by Lane Bryant.

We agree with the Director that *Quill* does not apply to taxes other than sales and use taxes, *Quill*, *supra*, 504 *U.S.* at 314, 112 *S. Ct.* at 1914, 119 *L. Ed.* 2d at 108 (stating "[w]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes. . . ."), and that the Corporation Business Tax may be constitutionally applied to impose a tax on plaintiff 's income from licensing fees attributable to New Jersey.

In *Geoffrey Inc. v. South Carolina Tax Comm'n*, 437 *S.E.*2d 13, 18, *cert. denied*, 510 *U.S.* 992, 114 *S. Ct.* 550, 126 *L. Ed.* 2d 451 (1993), the Supreme Court of South Carolina noted the distinction between the taxes involved in *Quill* and income taxes:

> It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus. *American Dairy Queen*, 93 *N.M.* at 747, 605 P.2d at 255. *See also Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 *U.S.* 435, 441- 442, 64 *S. Ct.* 1060, 1063-64, 88 *L.Ed.* 1373, 1379 (1944) (a state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are within the protection of the state and entitled to the numerous other benefits which it[ ] confers); *J. Hellerstein & W. Hellerstein*, *supra*, at 6.08 (any corporation that regularly exploits the markets of a state should be subject to its jurisdiction to impose an income tax even though

> not physically present). A taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business. *Curry*, 307 *U.S.* at 368, 59 *S. Ct.* at 906, 83 *L. Ed.* at 1348. We hold that by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a "substantial nexus" with South Carolina.
>
> [*Geoffrey, Inc.*, *supra*, 437 *S.E.*2d at 18.][4]

Accordingly, the South Carolina Supreme Court upheld the income tax imposed against the owner of trade names and trademarks for which Toys 'R Us paid a license fee for use in South Carolina. *Id.* at 17.

The recent and, in our view, the more persuasive authority leads us to join the jurisdictions which have followed *Geoffrey* and to uphold the tax. This is particularly true because, as the Tax Court stated, "the CBT statute is clearly intended to reach foreign corporations engaged in business activities within the state to the full extent that is constitutionally permissible." *Lanco*, *supra*, 21 *N.J. Tax* at 214, citing *Roadway Express, Inc. v. Director, Div. of Taxation*, 50 *N.J.* 471, 483, (1967), *appeal dismissed*, 390 *U.S.* 745, 88 *S. Ct.* 1443, 20 *L. Ed.* 2d 276 (1968). *See also Bendix Corp. v. Director, Div. of Taxation*, 125 *N.J.* 20, (1991) (assessment of capital gains tax on sales by corporation doing business in multiple states), *rev'd*, *sub*

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[4] In *Geoffrey* there was no commerce clause challenge based on the discrimination or unfair apportionment prongs. *Geoffrey* also rejected a due process challenge and found Geoffrey purposefully directed its activities to South Carolina by allowing the use of trademarks and intangible assets in the state. *Id.* at 17.

nom. Allied-Signal, Inc. v. Director, Div. of Taxation, 504 *U.S.* 768, 112 *S. Ct.* 2251, 119 *L. Ed.* 2d 533 (1992).

In *A & F Trademark, Inc. v. Tolson*, 605 *S.E.*2d 187 (N.C. Ct. App. 2004), *petition for cert. filed*, 73 *U.S.L.W.* 3719 (U.S. Jun. 06, 2005) (No. 04-1625), decided since the Tax Court's opinion in this case, the North Carolina Court of Appeals upheld the assessment of corporate franchise and income taxes against wholly-owned, non-domiciliary subsidiary corporations of Limited, Inc. *Id.* at 192-93. Like the plaintiffs in the case before us, the North Carolina taxpayers were related to a clothing retailer with stores in North Carolina and contended "that the presence of their intangible property in North Carolina [as a result of license fees paid for use of trademarks] is irrelevant in light of the lack of physical presence of offices, facilities, employees and real or tangible property," and that the United States Supreme Court's opinion in *Bellas Hess* required a finding that the tax sought to be imposed by North Carolina violated the Commerce Clause. *Id.* at 193. Specifically, the taxpayers asserted that "they did not have a substantial nexus with North Carolina because they have no physical presence in [the] State." *Ibid.*

The North Carolina Court of Appeals rejected the argument because "[b]oth *Bellas Hess* and *Quill* involved attempts by a state to require out-of-state mail-order vendors to collect and pay use taxes on goods purchased within the state despite the fact that the vendors had no outlets or sales representatives in the state." *Ibid.* According to the North Carolina Court of Appeals, the Supreme Court's decision in *Bellas Hess*, " 'stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause' " to support the tax, *ibid.* (quoting *Quill*, *supra*, 504 *U.S.* at 311, 112 *S. Ct.* at 1912, 119 *L. Ed.* 2d at

106), and *Quill* ultimately concluded that, "for purposes of sales and use taxes assessed against vendors whose only contact with a state is by mail or common carrier, the substantial nexus prong of *Complete Auto* could appropriately be determined by a 'bright-line, physical presence requirement.' " *Id.* at 194, quoting *Quill*, 504 *U.S.* at 317, 112 *S. Ct.* at 1916, 119 *L. Ed.* 2d at 110.

The North Carolina Court of Appeals stated three reasons for declining to adopt the broader reading of *Quill* as requiring a physical presence for income tax purposes. *Id.* at 194-95. "First, the tone in the *Quill* opinion hardly indicates a sweeping endorsement of the bright-line test it preserved, and the Supreme Court's hesitancy to embrace the test certainly counsels against expansion of it." *Id.* at 194. This was because in its discussion of the Commerce Clause, the Supreme Court noted that "while *Bellas Hess* did not conflict with recent Commerce Clause cases, 'contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today.' " *Ibid.* (quoting *Quill*, *supra*, 504 *U.S.* at 311, 112 *S. Ct.* at 1912, 119 *L. Ed.* 2d at 105). Stated differently, "recent Commerce Clause decisions . . . signaled a 'retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach.' " *Ibid.* (quoting *Quill*, 504 *U.S.* at 314, 317, 112 *S. Ct.* at 1914, 1915, 119 *L. Ed.* 2d at 107, 110). According to the North Carolina Court of Appeals:

> The [United States Supreme] Court further observed the physical-presence test, though offset by the clarity of the rule, was "artificial at its edges." *Quill*, 504 *U.S.* at 315, 112 *S. Ct.* at 1914, 119 *L. Ed.* 2d at 108. In addition, the Court twice noted that in other types of taxes, it had never articulated the same physical-presence requirement adopted in *Bellas*

> *Hess*, *see Quill*, 504 *U.S.* at 314 and 317, 112 *S. Ct.* at 1914 and 1915, 119 *L. Ed.* 2d at 108 and 110, but cautioned that the failure to expand the *Bellas Hess* rule established for sales and use taxes to other types of taxes did not imply that the *Bellas Hess* rule as applied to sales and use taxes was vestigial or disapproved. *Id.* Nonetheless, the Court's choice to abstain from rejecting the *Bellas Hess* rule for sales and use taxes fails to argue persuasively that the rule should, for lack of rejection, be augmented to cover other types of tax. While the Supreme Court may ultimately choose to expand the scope of the physical-presence test reaffirmed in *Quill* beyond sales and use taxes, its equivocal reaffirmation of that test does not readily make that choice self-evident.
>
> [*A & F Trademark*, *supra*, 605 *S.E.*2d at 194.]

The North Carolina court in *A & F Trademark* further stated that the retention of the *Bellas Hess* test in *Quill* was based on the principle of *stare decisis* and the "substantial reliance" on the physical-presence test, which had "become part of the basic framework of a sizable industry." *Ibid.* (quoting *Quill*, *supra*, 504 *U.S.* at 317, 112 *S. Ct.* at 1916, 119 *L. Ed.* 2d at 110). The North Carolina court concluded that it "need look no further than the language in *Quill* to summarily dispense with the possibility that *stare decisis* plays an analogous role" in a case involving neither the use or sales tax because the Supreme Court had twice expressed that the bright-line, physical-presence requirement of *Bellas Hess* "had not been adopted in other forms of taxation." *Ibid.* Furthermore, the court dismissed the possibility that analogous substantial reliance – as discussed in *Quill* – existed in the present case "since the physical-presence requirement has never been established by judicial precedent

for other forms of taxation," and the North Carolina form of taxation was relatively new. *Ibid.*

Finally, *A & F Trademark* relied on Jerome R. Hellerstein, *Geoffrey and the Physical Presence Nexus Requirement of Quill*, 8 *State Tax Notes* 671, 676 (1995), and found "important distinctions between sales and use taxes [as compared to] income and franchise taxes 'that makes the physical presence test of the vendor use tax collection cases inappropriate as a nexus test' " for taxation beyond the use and sales taxes. *A & F Trademark, supra*, 605 *S.E.*2d at 194-95. The court quoted the Hellerstein article to the effect that the " '[United States]' Supreme Court has made it clear that the presence of the recipient of income from intangible property in a state is not essential to the state's income tax on income of a nonresident.' " *Id.* at 194- 95 (quoting *Hellerstein, supra*, at 676).

Thus, the North Carolina court in *A & F Trademark* followed the determination in *Geoffrey*, which our Tax Court rejected, and concluded:

> [W]e reject the contention that physical presence is the *sine qua non* of a state's jurisdiction to tax under the Commerce Clause for purposes of income and franchise taxes. Rather, we hold that under facts such as these where a wholly-owned subsidiary licenses trademarks to a related retail company operating stores located within North Carolina, there exists a substantial nexus with the State sufficient to satisfy the Commerce Clause. *Accord Geoffrey*, 437 *S.E.*2d at 18 (holding that "by licensing intangibles [to Toys 'R Us, an affiliated operating store,] for use in [South Carolina] and deriving income from their use [t]here, Geoffrey ha[d] a 'substantial nexus' with South Carolina"); *Kmart* [*Properties, Inc. v.*

> *Taxation and Revenue Dep't of New Mexico*, No. 21, 140 at 13 (N.M. Ct. App. Nov. 27, 2001)] at 15 (holding that "the use of KPI's [the wholly-owned trademark holding company licensor] marks within New Mexico's economic market, for the purpose of generating substantial income for KPI, establishe[d] a sufficient nexus between that income and the legitimate interests of the state and justifie[d] the imposition of a state income tax").
>
> [*A & F Trademark, supra*, 605 *S.E.*2d at 195.]

Of particular interest, the court addressed this very case and stated:

> We are also cognizant of the holding of the New Jersey Tax Court in a case involving one of the taxpayers before this Court on the same issue. *Lanco, Inc. v. Dir., Div. of Tax'n.*, 21 *N.J. Tax* 200 (2003). In that case, the New Jersey Tax Court concluded "that the physical presence of the taxpayer or its employee(s), agent(s), or tangible property in a jurisdiction has been and remains an necessary element for a finding of substantial nexus under the Commerce Clause of the United States Constitution." *Id.*, 21 *N.J. Tax* at 214. We respectfully disagree. Summarizing the salient portions of that opinion, the New Jersey Tax Court (1) found it "illogical" to have a physical presence as a constitutional necessity for sales and use taxes but not for income tax, (2) opined physical presence, as a prerequisite to state taxation of income, was "fully consistent with and strongly suggested by the Commerce Clause cases decided before *Quill* "because the circumstances of those cases involved taxpayers who were physically present in the state

attempting to impose the tax, and (3) stated "other state court cases decided since *Quill* do not follow the *Geoffrey* rule." *Id.*, 21 *N.J. Tax* at 208-09.

Regarding the first reason given by the New Jersey Tax Court, the *Quill* opinion itself twice notes the singularity of its adoption and reaffirmation of the physical-presence test for Commerce Clause nexus in the arena of sales and use taxes. Moreover, as illustrated by our analysis herein, we disagree with the New Jersey Tax Court that there do not exist certain distinctions between the tax at issue in *Quill* and those considered in the instant case that justify divergent treatment. Regarding the second reason, we do not accord the same import to pre-*Quill* cases in which it was far more likely that a taxpayer would be required to be physically present (in the traditional commercial sense) in a state in order to earn income there. Lastly, the third reason espoused by the New Jersey Tax Court rings hollow. For example, in discussing *General Motors Corp. v. City of Seattle*, 107 *Wash. App.* 42, 25 *P.*3d 1022 (2001), *cert. den.*, 535 *U.S.* 1056, 122 *S. Ct.* 1915, 152 *L. Ed.* 2d 825 (2002), the New Jersey Tax Court dismisses the Washington appellate court's express declaration that it "decline[d] to extend *Quill's* physical presence requirement" to a business and occupation tax on the basis that the taxpayers in that case had a physical presence in that jurisdiction. The corporation's physical presence can hardly serve to obscure the Washington Court's unequivocal choice to stand with *Geoffrey's* containment of the *Quill* physical-presence test. More importantly, any assertion that *Geoffrey* has not been, by and large, approved of in subsequent cases cannot be sustained. *See* J. Hellerstein & W.

> Hellerstein, State Taxation, Para. 6.11[3] at 6-16 (Warren, Gorham & Lamont, 3d ed. Cum. Supp. 2004) (comprehensively analyzing judicial and administrative post- *Geoffrey* developments and summarizing that, although mixed, "judicial and administrative reaction to the opinion across the country has generally supported [*Geoffrey's*] position that *Quill's* physical-presence test of Commerce Clause nexus does not extend to income taxes").
>
> [*Id.* at 195-96 (footnote omitted).]

Similarly, in *Secy, Dep't of Revenue v. Gap (Apparel), Inc.*, 886 *So.*2d 459, 461-62 (La. Ct. App. 2004) (per curiam) (hereinafter "*Gap*"), the Louisiana Court of Appeals held that the state could impose a corporate income tax on Gap Apparel, a Delaware corporation, in circumstances involving intangible property almost identical to the facts before us. Apparel authorized the Gap and its affiliates to use registered trademarks, trade names and service marks for which it received "a royalty based on the net sales of the licensed products." *Id.* at 461. The court upheld the tax despite the absence of real or personal property, employees or other presence in Louisiana and the absence of the entry of any licensing agreement there, *id.* at 462, stating:

> [I]t is clear that the marks licensed by Apparel have been used in Louisiana in such a way as to become an integral part of the licensees' businesses in this state. Numerous marks (*i.e.* Gap, Baby Gap, Gap Kids, Pro Fleece) have been licensed by Apparel and used by the licensees to conduct and promote their businesses in this state. Clearly, the intangibles have acquired a business situs in Louisiana and are subject to taxation in this state.

[*Gap, supra*, 886 *So.*2d at 462.]

We are satisfied that the physical presence requirement applicable to use and sales taxes is not applicable to income tax and that the New Jersey Business Corporation Tax may be constitutionally applied to income derived by plaintiff from licensing fees attributable to New Jersey.

Accordingly, we reverse the judgment of the Tax Court and remand for further proceedings relating to the tax imposed consistent with this opinion.[5]

I hereby certify that the foregoing is
a true copy of the original on file in my office
/s/_____
ACTING CLERK OF THE APPELLATE DIVISION

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[5] It is unclear from the argument before us as to whether the unresolved dispute involves more than one year, *see Lanco, supra*, 21 *N.J. Tax* at 203-04 n.1, and other issues not disposed of by stipulation. As noted, *supra*, at 7, footnote 2 of this opinion, we have resolved the critical issue under review, and we remand to the Tax Court for resolution of all open issues or questions which arise in light of our judgment. However, because of the constitutional issue involved, we stay the remand if plaintiff files a timely direct appeal or, to be safe in case the Supreme Court does not consider the issue "substantial," *see R.* 2:2-1(a)(1), pending decision on a petition for certification.

APPENDIX C

TAX COURT OF NEW JERSEY

DOCKET NO. 005329-97

LANCO, INC.	:	
Plaintiff,	:	
v.	:	OPINION
DIRECTOR, DIVISION OF TAXATION,	:	
Defendant.	:	

Decided: October 23, 2003

Paul H. Frankel, Hollis L. Hyans, Craig B. Fields, of Counsel, and Amy F. Nogid, of Counsel, for Plaintiff
(Morrison & Foerster LLP, attorneys).
Charles M. Costenbader, of Counsel, for Plaintiff
(McCarter & English, LLP, attorneys).

Patrick DeAlmeida, for Defendant
(Peter C. Harvey, Attorney General of New Jersey).

Charles H. Friedrich, of Counsel, for Amicus Curiae New Jersey State Chamber of Commerce
(Stryker, Tams & Dill LLP, attorneys).

PIZZUTO, J.T.C.

This case presents the question of whether New Jersey may constitutionally subject a foreign corporation to the Corporation Business Tax (*N.J.S.A.* 54:10A-1 *et seq.*, "the CBT"), where the corporation has no physical presence in the state and derives income from a New Jersey source only pursuant to a license agreement with another corporation that conducts a retail business here.

Plaintiff Lanco, Inc., ("Lanco") is a Delaware corporation that owns certain intangible property (trademarks, trade names and service marks). The parties have stipulated that Lanco has no offices, employees, or real or tangible property in New Jersey. Lanco licenses Lane Bryant, Inc., ("Lane Bryant") to utilize the intangible property in the conduct of Lane Bryant's retail operations, including those in New Jersey, and in return receives royalty payments from Lane Bryant. Lanco and Lane Bryant are affiliated corporations, but the common ownership is not material to the constitutional issue concerning the determination by the defendant, Director of the Division of Taxation ("Director"), that activity under the license agreement makes Lanco subject to taxation in New Jersey. It is the determination that Lanco is obliged to file under the CBT, rather than the calculation of tax claimed to be due, that is contested.[1]

State taxation of entities engaged in interstate commerce must comport with the Due Process and Commerce Clauses of the United States Constitution. In the leading case of

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[1] The original determination required filings beginning in 1983. During the pendency of the action, however, the parties have stipulated that issues concerning certain reporting periods have been resolved and that the claims in this action are amended to address only the year ending January 31, 1998. The court has allowed the amendment.

Complete Auto Transit v. Brady, 430 *U.S.* 274, 97 *S.Ct.* 1076, 51 *L.Ed.*2d 326 (1977), the Supreme Court articulated the standard to determine whether, in the absence of Congressional action (when the clause is considered "dormant"), a particular instance of state taxation of interstate commerce is permitted under the Commerce Clause. *U.S. Const.* art. I, § 8, cl. 3. The Court formulated a four-part test that permits taxation "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." 430 *U.S.* at 279.

Until the decision in *Quill Corp. v. North Dakota*, 504 *U.S.* 298, 112 *S.Ct.* 1904, 119 *L.Ed.*2d 91 (1992), it was generally considered that the requirement of the Due Process Clause, *U.S. Const.* Amend. XIV, § 1, that an entity have certain minimum contacts with a taxing jurisdiction to support the imposition of a tax was not different from the substantial nexus component of the Commerce Clause standard. In *Quill*, however, the Supreme Court uncoupled the Due Process Clause analysis from the nexus test under the Commerce Clause. *Quill* concerned the use tax collection obligation[2] of a mail-order vendor of office supplies that had

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[2] States that impose a sales tax on retail transactions occurring within the state typically also impose a "compensating" use tax on the use of property whose sale in the jurisdiction would be taxable, when a sales tax has not been collected. *See N.J.S.A.* 54:32B-6. The litigation concerning mail-order vendors deals with the use tax collection obligation, rather than with the liability of the vendors to income taxation by jurisdictions into which they sell, because Congress has immunized mail-order vendors, among others, from income taxation by those jurisdictions. P.L. 86-272 (1959), codified at 15 USCA §§ 381 to 384. This statute was enacted in response to the Supreme Court's decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 *U.S.* 450, 79 *S.Ct.* 357, 3

no retail outlets or sales force in North Dakota and that shipped its products into that state by common carrier. The Court addressed the continuing vitality of its decision in *National Bellas Hess Inc. v. Department of Revenue of Ill.*, 386 *U.S.* 753, 87 *S.Ct.* 1389, 18 *L.Ed.*2d 505 (1967), which had held that a mailorder vendor may not constitutionally be required to collect from its customers a use tax imposed by the state within which its product is delivered, unless the vendor has a physical presence, more than *de minimis*, in that state. The presence may be associated with activities totally unrelated to the sale. Thus, the presence of offices handling advertisements in a publication will support the imposition of a use tax collection responsibility for items sold by the publisher. *Nat'l Geographic Soc. v. Cal. Bd. of Equalization*, 430 *U.S.* 551, 97 *S.Ct.* 1386, 51 *L.Ed.*2d 631 (1977). Moreover, the physical presence requirement may be satisfied by independent contractors who solicit sales, assist retailers or service the product sold. *See Scripto, Inc. v. Carson*, 362 *U.S.* 207, 80 *S.Ct.* 619, 4 *L.Ed.*2d. 660 (1960).

Quill determined that the *Bellas Hess* result remained sound, but as a matter of Commerce Clause jurisprudence only and not as a requirement of the Due Process Clause. Recognizing that a quarter-century of adjudication since *Bellas Hess* had produced a conception of due process in terms of minimum contacts, reasonable notice and basic fairness, the court concluded that North Dakota's assertion of an obligation on the part of *Quill* to collect use tax comported with due process. The majority (Justice Stevens joined by Chief Justice Rehnquist and Justices Blackmun, O'Connor and Souter) found, however, that the Commerce Clause

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*L.Ed.*2d 421 (1959), permitting appropriately apportioned state taxation of activities exclusively in furtherance of interstate commerce.

requirement of substantial nexus embodied other constitutional considerations:

> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. Under the Articles of Confederation, state taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills.
> . . . . Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause. [504 *U.S.* at 312-13.]

The determination that physical presence remains a requirement under the Commerce Clause for the imposition of a use tax collection responsibility rests to a significant extent on *stare decisis* principles. The majority opinion observed that "the *Bellas Hess* rule has engendered

substantial reliance and has become part of the basic framework of a sizable industry." 504 *U.S.* at 317. Moreover, it noted that the "underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." *Id.* at 318 (footnote omitted). Nevertheless, the decision does not simply reflect deference to precedent and recognition of Congressional authority. The majority clearly undertook an analysis of the physical presence requirement on its own merits. It concluded "[w]hile contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases." *Id.* at 311.

The opinions of the other Justices underscore that the majority found continuing value in the requirement of physical presence for constitutional exercise of State taxing power under the Commerce Clause. Justice White concurred with the majority's due process analysis and would have applied the same standard for the substantial nexus inquiry under the Commerce Clause. He would have overruled *Bellas Hess* and given it "the complete burial it justly deserves." *Id.* at 322 (White, J., concurring in part, dissenting in part). Justice Scalia, joined by Justices Kennedy and Thomas, concurred in the result, but expressly noted that he "would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*." *Id.* at 320 (Scalia, J., concurring).

The decisive question in this case is whether the physical presence requirement confirmed in *Quill* under the Commerce Clause applies simply to the use tax collection obligation directly at issue in that case, or whether it is also a necessary element of substantial nexus for the imposition of a state income or franchise tax. The *Quill* majority opinion

does not give an unambiguous answer to this question. In at least two places, the opinion observes that in cases concerning other types of taxes the Supreme Court has not articulated a physical presence requirement 504 *U.S.* at 314, 317. The opinion acknowledges however, that the Commerce Clause precedents considered by the North Dakota Supreme Court in sustaining a collection obligation for Quill involved businesses that were physically present in the taxing state. *Id.* at 314. Those cases were therefore, the court noted, consistent with *Bellas Hess.*

This question has been addressed both in litigation and in academic discussion subsequent to *Quill.* The earliest decision of a state court of last resort is *Geoffrey, Inc. v. South Carolina Tax Com'n*, 313 *S.C.* 15, 437 *S.E.*2d 13 (1993), *cert. den.* 510 *U.S.* 992, 114 *S.Ct.* 550, 126 *L.Ed.*2d 451 (1993). The *Geoffrey* fact pattern is materially indistinguishable from this case. Geoffrey, Inc., a wholly owned subsidiary of Toys R Us, Inc., was a Delaware corporation without property or employees in South Carolina. It owned trademarks and trade names that it licensed Toys R Us to use in that state. Toys R Us made royalty payments to Geoffrey and deducted those payments from income in determining its South Carolina income tax obligation. The South Carolina tax authorities initially disallowed the deduction, but eventually contended that Geoffrey was independently subject to taxation, notwithstanding that Geoffrey had no physical presence in the state. The South Carolina Supreme Court sustained this contention, commenting in the course of its decision that "[t]he net effect of this corporate structure has been the production of 'nowhere' income that escapes all state income taxation." 437 *S.E.*2d at 17, n.1.

The thesis that *Geoffrey* is correctly decided is comprehensively developed in two articles by Michael T.

Fatale, a tax attorney with the Massachusetts Department of Revenue: *Geoffrey Sidesteps Quill: Constitutional Nexus, Intangible Property and the State Taxation of Income*, 23 *Hofstra L. Rev* 407 (1994) and *State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard*, 54 *Tax Law* 105 (2000). The interpretation of *Quill* adopted in *Geoffrey* and advanced by the cited articles is a necessary component of the Director's argument in this case. It considers that *Quill* merely establishes a safe harbor with respect to the use tax collection obligation for vendors that do not have a physical presence in a state where their products are delivered. In other words, if a vendor does no more than solicit orders from outside the state and ship goods into the state by mail or common carrier, the vendor is not obliged to collect the state's use tax from its customers. Where the issue is not use tax collection, but liability for state taxation of income, it is argued that *Quill* permits a finding of liability by virtue of an intentional exploitation of the state's market without physical presence in the state.

This argument is not persuasive. In the first place, it does not appear that the differences between the use tax collection obligation, on the one hand, and liability for income taxation, on the other, are so significant as to justify a different rule for each concerning physical presence as an element of Commerce Clause nexus. Next, the Supreme Court cases decided before *Quill* strongly suggest that physical presence is a necessary element of nexus for income taxation. Finally, other state court cases decided since *Quill* do not follow the *Geoffrey* rule.

As noted previously, the Supreme Court's decision in *Quill* to retain the physical presence requirement rested on more than the principles of *stare decisis* and the mailorder industry's reliance on the *Bellas Hess* rule. The Court spoke of the "benefits of a clear rule . . . [that] firmly establishes the

boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes." 504 *U.S.* at 315. It is difficult to see distinctions that give virtue to physical presence as a necessary element of nexus in this area and not for purposes of income taxation. The *Quill* majority noted the discussion in *Bellas Hess* that potential imposition of sales taxes by more than 6000 jurisdictions raised a prospect of "many variations in rates of tax, in allowable exemptions and in administrative and record-keeping requirements" and "a wealth of complicated obligations." 504 *U.S.* at 313, n.6, quoting *Bellas Hess*, *supra* at 759-60. Even on the supposition that these complexities characterize use tax collection more than income tax liability, the record-keeping and classification tasks, considered complicated and onerous in 1967 when *Bellas Hess* was decided, are considerably less difficult under contemporary data-processing technology. *See Quill, supra*, 504 *U.S.* at 332 (White, J., concurring in part, dissenting in part). The use tax collection obligation does not, to put it plainly, seem significantly more burdensome than the liability to pay an income tax. If physical presence is a constitutional necessity for one, it is illogical that it should not be for both.

The conclusion that physical presence is necessary to support state taxation of income is fully consistent with and strongly suggested by the Commerce Clause cases decided before *Quill*. *Complete Auto* establishes a standard that can fairly be called a balancing test. It does not articulate the nexus component of the test in terms of physical presence, or any particular bright-line requirement. Nevertheless, the nexus question by its very nature is analyzed in terms of objective factors like presence. The *Quill* majority, moreover, noted that the precedents cited by the North Dakota Supreme Court concerned taxpayers physically present in the taxing state. In the use tax context, *Quill* establishes that physical presence, when coupled with the filling of orders from out-

of-state, tips the balance in favor of the collection obligation. With respect to income taxation, the question seems to be the sufficiency of other factors beyond physical presence, which is taken as a given, to establish taxing jurisdiction.

In propounding the thesis that Commerce Clause nexus does not require some element of physical presence, the articles cited above acknowledge the absence of precedent at the Supreme Court level sustaining imposition of an income tax on an entity without tangible property or other physical presence in the taxing jurisdiction. The earlier article approvingly analyzes the *Geoffrey* decision and argues for wide application of its reasoning. It proposes that the business-situs rule may be invoked to establish nexus for taxation on the basis of the use of intangible property in the taxing state. The business-situs rule, applied in several cases decided nearly a century ago, permits intangibles to be assigned a tax situs in a state where the owner is not physically present. The cases concerned *ad valorem* property taxation, and the issue was due process. The article claims support from only one income tax case decided by the United States Supreme Court, *New York ex. rel. Whitney v. Graves*, 299 *U.S.* 366, 57 *S.Ct.* 237, 81 *L.Ed.* 285 (1937). *Whitney* is also a due process case, in which New York was found to have jurisdiction to tax a Massachusetts resident on income from the sale of a right derived from a seat on the New York Stock Exchange.

The second article defends the proposition that the *Quill* requirement of physical presence applies only in the use tax collection context and discusses state court litigation subsequent to *Quill*. It demonstrates that there has been considerable activity, especially since the decision in *Geoffrey*. Nevertheless, South Carolina remains the only state which has found nexus without physical presence. The *Geoffrey* holding, of course, is binding precedent only in

South Carolina. The Supreme Court's denial of *certiorari* does not address the merits of the decision. *Hughes Tool Co. v. Trans World Airlines, Inc.*, 409 *U.S.* 363, 365, 93 *S.Ct.* 647, 34 *L.Ed.*2d 577 (1973). *See also Ponte v. Real*, 471 *U.S.* 491, 502, 105 *S.Ct.* 2192, 85 *L.Ed.*2d 553 (1985) (Stevens, J., concurring in part). In its discussion of the Commerce Clause, *Geoffrey* recites the four-part test of *Complete Auto.* Then, the opinion summarily concludes, in a footnote, that in *Quill* the Supreme Court "revisited the physical presence requirement of *Bellas Hess* and while reaffirming its validity as to *sales and use taxes*, noted that the physical presence requirement had not been extended to other types of taxes." 437 *S.E.*2d at 23, n.4. The opinion goes on to declare that "[i]t is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus." *Id.* at 23. In support of the proposition, it cites a New Mexico state court decision and the U.S. Supreme Court decision in *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 *U.S.* 435, 441-42, 64 *S.Ct.* 1060, 88 *L.Ed.* 1373 (1944).

The *International Harvester* decision concerned a due process challenge by a foreign corporation doing business in Wisconsin to a state statute imposing a tax on that portion of dividends distributed by both domestic and foreign corporations as was derived from income earned in Wisconsin. The tax was imposed on the corporation, which was required to deduct the amount of the imposition from the dividends distributed to individual shareholders, who thus bore the burden of the tax. The Supreme Court upheld the tax, concluding that "a state has constitutional power to make a levy upon a corporation, measured by so much of its earnings from within the state as it distributes in dividends, and to make the taxable event the corporation's relinquishment of the earnings to its stockholders." 322 *U.S.*

441. In these circumstances, the Court declared "[p]ersonal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them." *Id.* The broad proposition which *Geoffrey* takes from *International Harvester* that "a state may tax such part of the income of a nonresident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are within the protection of the state and entitled to the numerous other benefits which it confers" is in the nature of dictum. 437 *S.E.*2d at 23.

The only other decision cited in the Commerce Clause section of *Geoffrey* is *Curry v. McCanless*, 307 *U.S.* 357, 59 *S.Ct.* 900, 83 *L.Ed.* 1339 (1939). This case concluded that due process permits an inheritance or succession tax to be imposed, with respect to a decedent's disposition of intangible assets held in trust, by both the decedent's state of domicile and the state where the trustee is found. Neither *Curry v. McCanless* nor *International Harvester* directly addressed the Commerce Clause and in each case physical presence, in the one instance of the trustee and in the other of the corporation, was an essential factor in the finding of jurisdiction to tax. The authorities cited by the South Carolina Court do not support its conclusion that Commerce Clause nexus may be found absent physical presence ascribable to a taxpayer.

The question of the necessity of physical presence for Commerce Clause nexus has been addressed in other state court decisions after *Quill* and *Geoffrey*. None of them find nexus absent physical presence. *J.C. Penney Nat'l Bank v. Johnson*, 19 *S.W.*3d 831 (Tenn. App. 1999), moreover, clearly rejects the reasoning of *Geoffrey*. The Tennessee court concluded that income realized by a Delaware banking

corporation from credit card activity in Tennessee was not subject to Tennessee's franchise and excise taxes. The court observed that it could find no basis to differentiate between the use collection obligation addressed in *Quill* and the taxes imposed by Tennessee. Without specifically addressing *Geoffrey*, the decision found that under *Quill* physical presence is necessary for a finding of Commerce Clause nexus.

In another case, on facts like those in *Geoffrey* and the instant matter, the Maryland Court of Appeals reversed the holding of the Maryland Tax Court that a Delaware corporation, affiliated with a local retailer, is not subject to taxation where its only contact with Maryland is a license agreement with the retailer. *Comptroller of the Treasury v. SYL Inc.*, 375 *Md.* 78, 825 *A.*2d 399 (2003). In doing so, the Court did not find that the license of intangible property for use within a state, without more, establishes Commerce Clause nexus for taxation of the licensor by the state within which the property is used. Rather, it concluded that the licensing corporation had no economic substance as a separate business entity, apart from the licensee. Although the court cited *Geoffrey* favorably, it also invoked the decision in *Syms Corp. v. Comm'r. of Revenue*, 436 *Mass.* 505, 765 *N.E.*2d 758 (2002), in which the deduction of royalty payments to an affiliated corporation was disallowed in the computation of a retailer's taxable income because the payments resulted from a "sham transaction." The Maryland decision is not, therefore, an unqualified adoption of *Geoffrey*, and it does not support the Division's contention in this matter.

Other decisions taking note of *Geoffrey* do not directly address the question of whether physical presence is required to establish nexus. *Truck Renting & Leasing Assn., Inc. v. Comm'r of Revenue*, 433 *Mass.* 733, 746 *N.E.*2d 143 (2001),

sustains the imposition of the Massachusetts corporate excise tax to a foreign corporation that entered into lease agreements under which its trucks were operated in Massachusetts by the lessees. Although the issue of nexus without physical presence is noted in passing, the decision turns on the anticipated presence and use of the lessor's tangible property in the state. *Couchot v. State Lottery Comm'n.*, 74 *Ohio* St. 417, 659 *N.E.*2d 1225 (1996), holds a non-resident liable for state income tax on Ohio lottery winnings. Citing *Geoffrey*, the court considered that the physical presence requirement of *Quill* was inapplicable in the case. Nevertheless, the decision notes that the taxpayer was physically present in Ohio in both purchasing and redeeming the winning lottery ticket. *General Motors Corp. v. City of Seattle*, 107 *Wash.App.* 42, 25 *P.*3d 1022 (2001) *rev. den.* 145 *Wash.*2d 1014, 35 *P.*3d 381 (2001), *cert. den.* 525 *U.S.* 1056, 122 *S.Ct.* 1915, 152 *L.Ed.*2d 815 (2002), concerns a local business and occupation tax, to which General Motors and Chrysler Corporations were found subject because, among other factors, their sales, service and parts representatives made regular visits to Seattle dealerships. In its discussion of *Quill* and *Geoffrey*, the court distinguished the tax at issue from both sales and use taxes and corporate franchise taxes and concluded that "[w]e decline to extend *Quill's* physical presence requirement in this context." 25 *P.*2d at 1022. It is clear, however, that the automobile manufacturers had a physical presence in the taxing jurisdiction. Finally, in *Acme Royalty Co. v. Director of Revenue*, 96 *S.W.*3d 72 (Mo. 2002) the Missouri Supreme Court, in a 4-3 decision interpreting state law, found that the state's corporate income tax statute did not reach income received by foreign corporations from licenses of trademarks, trade names and patents to related corporations operating in Missouri. The dissenting judges, invoking *Geoffrey* with respect to federal constitutional questions, would have found the corporations subject to tax.

This analysis leads to the conclusion that the physical presence of the taxpayer or its employee(s), agent(s), or tangible property in a jurisdiction has been and remains a necessary element for a finding of substantial nexus under the Commerce Clause of the United States Constitution. This constitutional issue must be reached, although Lanco advances an alternative argument that subjecting it to tax on the basis of its license agreement with Lane Bryant is not consistent with the terms of the New Jersey Corporation Business Tax Act (*N.J.S.A.* 54:10-A *et seq.*) The statutory argument fails because the CBT statute is clearly intended to reach foreign corporations engaged in business activities within the state to the full extent that is constitutionally permissible. *Roadway Express, Inc. v. Dir., Division of Taxation*, 50 *N.J.* 471, 483 (1967) *appeal dism,* 390 *U.S.* 745, 88 *S.Ct.* 1443, 20 *L.Ed.*2d 276 (1968).

The dispositive conclusion under the Commerce Clause also renders unnecessary extended discussion of other questions presented and expert testimony produced. Some discussion of those matters, however, is useful for an understanding of this decision. Lanco has argued, in particular, that not only the Commerce Clause, but also the Due Process Clause, immunizes it from taxation in New Jersey. Yet it is impossible to conclude that its agreement with Lane Bryant does not satisfy the *Quill* due process standard in that Lanco has purposefully availed itself of the benefits of an economic market in New Jersey. *See Quill*, 504 *U.S.* at 307-08. Similarly, any contention that other elements of the four-part *Complete Auto* test are not satisfied is without merit. Since this case concerns not an assessment, but a determination of responsibility to file, the fair apportionment element of the *Complete Auto* test is not raised as an issue. The remaining elements concern discrimination and fair relation to benefits provided by the

state. It is beyond question that the state seeks to tax license income of both domestic and foreign corporations and among the latter class to tax both those physically present and those not. There is simply no distinction made upon which a discrimination claim can be founded. As to fair relationship to services, it is clear that Lanco's intangibles are utilized in the conduct of Lane Bryant's retail business. Although it is not physically present in the state, Lanco clearly enjoys the same benefits provided to Lane Bryant.

Both parties presented testimony of economic experts. David Wildasin, Professor of Economics at Vanderbilt University testified as part of plaintiff's case. He concluded that it is undesirable on economic grounds for states to tax the income of corporations that have no physical presence in the taxing state. He considered it important that states have revenue mechanisms enabling them to tax entities that impose costs on the states to provide public services. In Wildasin's view, businesses that are physically present impose such costs, while those without physical presence do not. A licensor of intangibles like Lanco receives, the expert acknowledged, an indirect benefit from the state in which its licensee conducts business, but that benefit does not support taxation. Taxation based upon indirect benefit, in his opinion, would produce adverse consequences in the form of multiple taxation, discouragement of commerce, export of tax burden, and potentially disparate taxation of separate economic sectors; while taxation based on physical presence would have no adverse consequences.

Defendant presented the testimony of James Kearl, Professor of Economics at Brigham Young University. He observed that there is no necessary relationship between the magnitude of the costs imposed on a state by a given taxpayer's activity in the state and the amount of revenue collected from that taxpayer. He considered that Lanco's

licensure of intangibles for use in New Jersey imposes costs on the state because it generates economic activity that increases the demand for public services; and he further considered that Lanco benefits from this activity, since it receives fees that increase with sales. Kearl concluded that the imposition of a corporate income tax on a licensor like Lanco is warranted by economic factors and that it would produce no substantial distortions of economic behavior. He regarded broadening the tax base to include entities without physical presence in the state as permitting the lowering of the tax rate and the reduction of the overall impact of the corporation tax on economic incentives and behavior.

Plaintiff also offered the testimony of Richard D. Pomp, Professor of Law at the University of Connecticut. Pomp is one of the leading academic authorities in state and local taxation and was qualified as an expert in tax policy. As such, he enumerated six principles of tax policy that he regarded as representing the values inherent in the commerce clause: desirability of a clear or "bright-line" test, consistency with settled expectations, reduction of litigation and promotion of interstate investment, nondiscriminatory treatment of the service sector, avoidance of multiple taxation, and efficiency of administration. He concluded that a requirement for physical presence as an element of Commerce Clause nexus advances each of these principles to a greater extent than a rule establishing nexus on the basis of use of intangible property. Pomp also found no reason to distinguish between the use tax collection obligation, directly involved in *Quill*, and the obligation to pay the corporate tax at issue here in terms of considerations relating to nexus. Finally, he described how the method of combined reporting for corporate taxation would permit taxation of income received by a foreign corporation for use of intangible property in the taxing state by a related corporation, even

under a nexus rule requiring physical presence, and he endorsed combined reporting as sound tax policy.[3]

Economic and tax policy considerations are unquestionably valid material for the Supreme Court to consider in its task of constitutional adjudication. Those considerations are also appropriately addressed by the Legislature when it formulates the statutory scheme of taxation. Expert testimony does not, however, bear upon the question of whether the requirement of physical presence for Commerce Clause nexus is, following *Quill*, applicable beyond the use tax collection situation. That is a question of the interpretation of case law. Once it is determined that the precedents continue to require physical presence for nexus, there is no further question in this case for expert testimony to address.

A question of retroactivity has also been raised in the *amicus curiae* brief filed by the New Jersey Chamber of Commerce. It is argued that the regulation adopted by the Director expanding the definition of doing business under the Corporation Business Tax (under which the determination at

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[3] Combined reporting is distinguished from separate-entity reporting. Under the latter, each corporation or other business entity reports only its own income, while under the former a combined report is submitted for a parent corporation and all its subsidiaries that disregards inter-company transactions. In either system, all income of any unitary business conducted in whole or in part within the State is reported, and the taxable portion is determined by an apportionment formula. *See* Pomp & Oldman, *State & Local Taxation*, 10-29 to 10-36 (3d ed. 2000). *Allied-Signal Inc., v. Director, Div. of Taxation*, 504 *U.S.* 768, 112 *S.Ct.* 2251, 119 *L.Ed.*2d 533 (1992) discusses the unitary business concept in its application to New Jersey as a separate-entity jurisdiction.

issue was made) should be applied only prospectively. The regulation, amending *N.J.A.C.* 18:7-1.9 to include the licensure of trademarks to retailers operating in New Jersey was adopted in 1996. 28 *N.J.R.* 4795(a). It is unquestionably the Director's response to the question of the necessity of physical presence for nexus in light of *Quill* and *Geoffrey*. This decision concludes that physical presence is a necessary element for Commerce Clause nexus after *Quill*. Moreover, the tax period that remains in dispute between the parties begins after the effective date of the amendment. The retroactivity question is therefore moot.

Nevertheless, if physical presence were no longer a necessary element for nexus, retroactive application of a rule permitting a finding of nexus without physical presence would appear problematical. Regulations interpreting the terms of a tax statute do not by their own force impose taxes, and by their nature they are ordinarily retroactive to the statute's effective date. *Sharps, Pixley, Inc. v. Director, Div. of Taxation*, 16 *N.J. Tax* 626, 640 (Tax 1997); *General Bldg. Prod. Corp. v. Director, Div. of Taxation*, 14 *N.J. Tax* 232, 247 (Tax 1994) *aff 'd*, 15 *N.J. Tax* 213 (App. Div. 1995). Where, however, a tax regulation is premised on a perceived change in federal constitutional law, the same considerations do not necessarily apply. New Jersey has settled precedent, antedating *Quill* and *Geoffrey*, that bases nexus on physical presence. *Avco Financial Services Consumer Discount Company, One, Inc. v. Director, Div. of Taxation*, 100 *N.J.* 27, 38 (1985) (finding "substantial physical presence"); *Chemical Realty Corp. v. Director, Div. of Taxation*, 5 *N.J. Tax* 581, 612 (Tax 1983), *aff'd* 6 *N.J.* 448 (App. 1984). A finding of nexus without physical presence would clearly reflect a change in applicable law. In these circumstances, this court could reasonably conclude that the novelty of the change and the reliance interests of taxpayers under the former interpretation justify confining the new rule to

application only after the effective date of the amendment to the regulation. *Cf. State Troopers Fraternal Ass'n of N.J., Inc. v. State*, 149 *N.J.* 38 (1997).

It is appropriate to note, in addition, certain considerations that arise from the particular facts of this case. The plaintiff, while not physically present in the state, does have a direct long-term contractual relationship with a related entity clearly doing business in New Jersey. The case does not therefore concern isolated transactions, indirect connections or distant actors who cannot anticipate where the products of their effort, tangible or intangible, may come to be employed. If physical presence were not a requirement, nexus might be found in the circumstances there is no direct contractual relationship between the producer of property and its user in this state. There are other factors besides physical presence that can limit nexus findings and prevent taxation of remote parties. Certainly the due process standards of notice and fair warning will continue to hold. This decision concludes, however, that physical presence continues to be a requirement of the Commerce Clause.

This case and *Geoffrey*, as well as certain decisions in other states dealing with the necessity of physical presence for nexus, concern corporations organized to hold intangible property used in a retail or other business by an affiliated corporation. They are usually incorporated in jurisdictions that do not tax them on the receipt of license or royalty income from the operating company, which takes a deduction from its own income for the royalty payment as an ordinary business expense. The result is that the single enterprise which includes the two corporations receives income, not taxable under traditional nexus rules in any jurisdiction, which the *Geoffrey* court characterized as "nowhere income." Among the reasons, and perhaps the decisive reason, for placing ownership of intangibles in a separate corporation, is

the avoidance of taxation. Michael A. Lisi, Practicing Law Institute, *Intracorporate Licensing: A Domestic Trademark Holding Company Example*, (PLI Order No. G4-4033, Mar. 1998).

Legitimate means to minimize taxation are, of course, the prerogative of any business and perhaps the dictate of market-place competition. It is a familiar principle that a taxpayer is bound by its choice among different structures or transactions and must pay more tax, if it has chosen one means rather than another that would accomplish the same result with lower tax consequences. *General Trading Co. v. Director, Div. of Taxation*, 83 *N.J.* 122 (1980). The taxing authority is similarly bound where the taxpayer has chosen shrewdly.

This decision determines that the state may not assert nexus, absent physical presence, against a corporation that receives income from the use of trademarks or other intangibles employed in a New Jersey business conducted by an affiliated corporation. The particular technique of tax avoidance can, however, be addressed by other measures. Certain jurisdictions require combined reporting by all corporate components of an enterprise engaged in a unitary business conducted in part within the taxing state. Combined reporting would, as Professor Pomp noted, return to taxable income the royalty payment received by the holding company. Other jurisdictions have elected to disallow the deduction by the operating company. New Jersey is not a combined reporting jurisdiction, but a recent amendment to the CBT disallows deductions for royalty payments made to a related entity for use of intangible property, as those terms are defined in the statute. *N.J.S.A.* 54:10A-4.4. (enacted as *L.* 2002, *c.* 40, *sec.* 33, effective July 2, 2002). This opinion, of course, does not address the interpretation of the amendment in any particular factual situation. In circumstances when the

amendment does apply, however, jurisdiction to tax the company receiving royalty income from use of its intangibles in New Jersey is not essential to capture that income in this state's tax base.

In conclusion, since it has been determined that physical presence is a necessary element of Commerce Clause nexus for taxation, judgment shall be entered in favor of plaintiff Lanco invalidating the Director's determination that it is subject to the New Jersey Corporation Business Tax.

APPENDIX D

REVISED STATUTES OF NEW JERSEY, 1937 (As Amended to Date), TITLE 54 – TAXATION, SUBTITLE 4 – PARTICULAR TAXES ON CORPORATIONS AND OTHERS, PART 1. –PROVISIONS APPLICABLE TO CORPORATIONS GENERALLY, Ch. 10A. Corporation Business Tax Act (1945) (As added by Ch. 162, Laws 1945, effective January 1, 1946, as amended to date.).

Sec. 54:10A-2. Franchise tax; annual payment in lieu of taxes upon intangible personal property; "doing business, employing or owning capital or property in state" defined. –

Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for the year one thousand nine hundred and forty-six and each year thereafter, as hereinafter provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act [chapter] but, whenever such corporation holds shares of stock in a bank as defined in R. S. 54:9-1, and such bank has not elected to have the taxable value of such shares assessed to it and to pay the tax levied against such shares as provided in R. S. 54:9-14, or, having made such election, such bank subsequently revokes it, the provisions of this section shall not exempt such shares of stock from the tax imposed by chapter 9 of Title 54 of the Revised Statutes.

(As amended by Ch. 95, Laws 1973, effective April 25, 1973.)

A foreign corporation shall not be deemed to be doing business, employing or owning capital or property in the State, for the purposes of this act [chapter], by reason of (1) the maintenance of cash balances with banks or trust companies in this State, or (2) the ownership of shares of stock or securities in this State if such shares or securities are pledged as collateral security, or deposited with one or more banks or trust companies or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (3) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation.

(Sec. 54:10A-2 above is as amended by Ch. 95, Laws 1973, effective April 25, 1973.)

New Jersey Regulation, Reg. 18:7-1.6. **Subjectivity To Tax – How Created. –**

(a) Every corporation not expressly exempted is deemed to be subject to tax under the Act and is required to file a return and pay a tax thereunder provided it falls within any one of the following:

1. Existing under the laws of the State of New Jersey; or

2. If a foreign corporation,

i. Holding a general certificate of Authority to do business in this State issued by the Secretary of State; or

ii. Holding a certificate, license or other authorization issued by any other State department or agency, authorizing the company to engage in corporate activity within this State; or

iii. Doing business in this State; or

iv. Employing or owning capital in this State; or

v. Employing or owning property in this State; or

vi. Maintaining an office in this State.

(Amended November 4, 1996.)

New Jersey Regulation, Reg. 18:7-1.9. **Doing Business in New Jersey; Definition and Rules of Construction. –**

(a) The term "doing business" is used in a comprehensive sense and includes all activities which occupy the time or labor of men for profit.

1. Regardless of the nature of its activities, every corporation organized for profit and carrying out any of the purposes of its organization within the State shall be deemed to be "doing business" for the purposes of this Act.

2. In determining whether a corporation is "doing business," it is immaterial whether its activities result in a profit or a loss.

(b) Whether a foreign corporation is doing business in New Jersey is determined by the facts in each case. Consideration is given to such factors as:

1. The nature and extent of the activities of the corporation in New Jersey;

2. The location of its offices and other places of business;

3. The continuity, frequency and regularity of the activities of the corporation in New Jersey;

4. The employment in New Jersey of agents, officers and employees;

5. The location of the actual seat of management or control of the corporation.

Example

Foreign corporation R holds trademarks that were assigned to it by its parent corporation. R receives fees as a result of licensing those trademarks to certain New Jersey companies for use in New Jersey. R is subject to the corporation business tax on its apportioned income as a result of its trademark licensing activities.

(c) A foreign corporation shall not be deemed to be doing business or employing or owning capital or property in this State for the purposes of the Act by reason of the following:

1. The maintenance of cash balances with banks or trust companies in New Jersey;

2. The ownership of shares of stock or securities kept in New Jersey in a safe deposit box, safe, vault or other receptacle rented for the purpose, or pledged as collateral security, or deposited with one or more banks or trust companies, or brokers who are members of a recognized security exchange, in safekeeping or custody accounts;

3. The taking of any action by any such bank or trust company or broker which is incidental to the rendering of safekeeping or custodian service to such corporation.

4. Any combination of the foregoing activities.

(d) If the only business activity of a foreign corporation within New Jersey consists of the solicitation of orders for sales of its tangible personal property, which orders are to be sent outside the State for acceptance or rejection and, if accepted, are to be filled by shipment or delivery from a point outside the State, then such corporation is doing business in New Jersey and is subject to the tax. Unless it has additional contacts with New Jersey, however, it will not be liable for any tax measured by the income of the corporation. (See P.L. 86-272, U.S.C. §381). The corporation will be liable for filing a return and payment of the minimum tax.

1. For the in-State activities of the foreign corporation to immunize the corporation from taxation measured by income, such activities must be limited solely to:

i. Speech or conduct that explicitly or implicitly invites an order; and

ii. Activities that neither explicitly nor implicitly invite an order but that are entirely ancillary to requests for an order.

2. Examples of additional activities or contact with New Jersey that will subject a corporation to the tax based on or measured by income are:

i. Repairs, maintenance, and installations;

ii. Collection or repossession activities;

iii. Credit investigations;

iv. Personnel courses or lectures;

v. Technical assistance;

vi. Customer complaint resolution if the sole purpose is not to ingratiate sales personnel with the customer;

vii. Approving or accepting orders or securing deposits on sales;

viii. Acquiring personnel for other than solicitation activities;

ix. Maintaining a display at a single location in excess of two weeks during the tax year;

x. Carrying samples for sale, exchange or distribution in any manner for consideration or other value;

xi. Owning, leasing, or maintaining instate facilities such as a warehouse or answering service; and

xii. Consignment of personal property.

3. Examples of additional activities which, together with the solicitation activities described in (d)1 above will not subject corporation to tax based on or measured by income are:

i. Solicitation of orders through advertising;

ii. Carrying samples for display or distribution without charge;

iii. Providing automobiles, owned or leased, registered or not registered in New Jersey to sales personnel for their use in conducting protected activities;

iv. Checking customer inventories without charge;

v. Maintaining a display at a single location for less than two weeks during the tax year;

vi. Recruitment, training, or evaluating of sales personnel;

vii. A sales employee's in-home work space that is not paid for by the company; and

viii. Mediating customer complaints if just to ingratiate sales personnel with the customer.

(e) Independent contractors may solicit or make sales or maintain an office without subjecting a company to liability for tax based on or measured by income. Sales representatives who represent a single principal would not be considered independent contractors. A corporation would be subject to income based tax if the independent contractor maintained a stock of goods in the State under consignment or for purposes other than for display and solicitation.

Example

Foreign corporation L, represented in New Jersey by a foreign independent contractor, licensing software to New Jersey businesses. L receives fees from New Jersey companies for licensing the software. L is subject to the corporation business tax on its apportioned income.

(Amended April 18, 1994, April 3, 1995; November 4, 1996.)

APPENDIX E

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TAX COURT OF NEW JERSEY
DOCKET NO. 005329-1997

LANCO, INC.,	Civil Action
Plaintiff,	JOINT STIPULATION OF FACTS
v.	
DIRECTOR, DIVISION OF TAXATION,	[Exhibits to the Joint Stipulation of Facts are Intentionally Omitted]
Defendant.	

The parties hereby stipulate to the following facts for the purposes of the issues pending in the above-entitled matter only. Entry into this Joint Stipulation of Facts does not constitute a waiver of any objections as to the relevancy of the stipulated facts contained therein.

1. The issue in this case is whether Lanco, Inc. ("Lanco") is subject to tax under the Corporation Business Tax ("CBT") Act and is required to file CBT returns for the period February 11, 1983 through the present ("the period in issue"). Unless otherwise specified, all statements below refer to the period in issue.

2. Attached hereto as Exhibit A is a copy of the Complaint that was timely filed by Lanco. Attached to the Complaint is a copy of the determination issued by the Division of Taxation ("Division") to Lanco dated June 26, 1997, asserting that Lanco is required to file CBT returns for the period in issue (the "Subjectivity Notice"). Also attached to the Complaint is a copy of the New Jersey Schedule N (Nexus-Immune Activities Declaration) which was submitted by Lanco to the Division.

3. Attached hereto as Exhibit B is a copy of the Answer that was filed by the Director, Division of Taxation ("Director").

4. Lanco was incorporated in Delaware on December 15, 1982.

5. Lanco was formed to own, protect and license various trademarks, trade names and service marks (together, the "marks").

6. Lanco has registered all of its marks with the United States Patent and Trademark Office. Attached hereto as Exhibit C is an example of such a registration for one of the marks.

7. Lanco also registered its marks in numerous countries outside of the United States of America. Attached hereto as Exhibit D is a schedule of the dates that applications for some of such registrations were filed in other countries, copies of the registrations, and print-outs of the records maintained concerning the registrations.

8. No registration of any of the marks was ever obtained in the State of New Jersey by Lanco.

9. Lane Bryant, Inc. ("Lane Bryant") was incorporated in Delaware on April 26, 1982.

10. Lane Bryant is engaged in the nationwide retail sale of women's clothing and accessories.

11. Lanco and Lane Bryant are related by common ownership. Both Lanco and Lane Bryant are indirect subsidiaries of The Limited, Inc.

12. Pursuant to written agreement, Lanco licenses the use of its marks to Lane Bryant. Attached hereto as Exhibit E is a copy of the license agreement that is currently in effect.

13. Lanco receives royalty payments from Lane Bryant. The royalties are at arm's length rates.

14. Lane Bryant utilizes the marks in its business throughout the United States, including in New Jersey.

15. Lanco conducts all of its licensing activities from outside of New Jersey.

16. Lanco maintains no bank account, certificate of deposit or other financial accounts or safe deposit boxes at a banking institution within the State of New Jersey.

17. Lanco holds no interests in real property located in the State of New Jersey.

18. Lanco does not own any interest in tangible personal property located in the State of New Jersey.

19. Lanco has never maintained an office in the State of New Jersey. Originally, from 1983 through 1988, its offices were at 2625 Concord Pike, Wilmington, Delaware. Beginning January 9, 1989, Lanco's office was located at 1404 Foulk Road, Foulkstone Plaza, Wilmington, Delaware. From 1990 through the present, Lanco has had its office at

1105 North Market Street, Suite 902, Wilmington, Delaware 19899-8985.

20. Lanco has no officers or employees performing work for it in the State of New Jersey.

21. Lanco's Board of Directors has never held any meetings in the State of New Jersey. Lanco's shareholders have never held any meetings in the State of New Jersey.

22. Lanco has no agents in the State of New Jersey.

23. Lanco has never organized or sponsored any meetings in the State of New Jersey.

24. Lanco has purchased no goods or services from a contractor, subcontractor or vendor located in the State of New Jersey.

25. All of Lanco's activities concerning the protection of its marks occur outside New Jersey.

26. Attached as Exhibit F is Plaintiff 's Response to Defendant's First Supplemental Interrogatories.

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